

# **DCAAM 7640.1, DCAA Contract Audit Manual**

## **Chapter 13**

### **Audits at Educational Institutions, Nonprofit Organizations, and Federally Funded Research and Development Centers**

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# **13-000 Audits at Educational Institutions and Nonprofit Organizations \*\***

## **13-001 Scope of Chapter \*\***

a. This chapter provides guidance for conducting audits at universities, nonprofits, not-for-profits, and Federally Funded Research and Development Centers (FFRDCs). Although nonprofit and not-for-profit entities are technically different, and may be a foundation or institute, this chapter will use the term “nonprofit” when referring to organizations other than Institutions of Higher Education (IHE). For IHEs, the use of the terms “educational institutions”, “university”, “institution” and “IHE” are used interchangeably.

b. Sections 100 through 500 provide guidance that is common to both IHEs and nonprofit organizations.

c. Guidance specific to nonprofit organizations is provided in [Section 600](#).

d. Guidance specific to educational institutions is provided in [Section 700](#).

e. Guidance related to performance of the Single Audit (previously referred to as A-133 Audits) is provided in [section 800](#).

f. Guidance specific to Federally Funded Research Development Centers and University Affiliated Research Centers is provided in [section 900](#).

## **13-100 Section 1 - General Information \*\***

This section provides an overview of audit services performed at educational institutions and nonprofit organizations:

### **13-101 Audit Service for DoD Agencies \*\***

DCAA provides audit services for the Department of Defense and will generally perform audits at the request of all DoD components. The majority of the work is requested by the Office of Naval Research (ONR). When an audit of indirect rates is requested by other than ONR, the auditor should first determine who is cognizant over the indirect rates. This can be done by accessing the [Federal Audit Clearinghouse](#) and searching for the entity’s most recent Single Audit reporting package. If DoD is not cognizant over indirect rates, contact the requestor and let them know which agency is responsible for negotiating the entity’s indirect rates.

### **13-102 Audit Services for non-DoD Agencies \*\***

DCAA will provide audit services to a non-DoD Agency when there is a cross-servicing arrangement between DCAA and the Federal agency (15-102). DCAA advisory and/or audit services for nonprofit organizations and universities are typically limited to audits of price proposals, public vouchers, or specific DoD program costs. When providing these or any services, the auditor must coordinate, to the maximum extent possible, with the cognizant Federal auditors and the auditee's independent public accounting firm (IPA) or the State Audit Office that performed the [Single Audit](#) for the year corresponding to the fiscal year of the subject matter of the audit in order to avoid duplicating audit procedures. If Health and Human Services

(HHS) or another non-DoD cognizant agency declines, or is unable, to provide audit services necessary for DoD agencies to accomplish their responsibilities, DCAA can provide services when:

- A DoD contracting or grants officer specifically requests, in writing, approval for use of DCAA audit services from the cognizant audit agency, and
- The cognizant audit agency provides written approval of DCAA performance of the requested audit services.

### **13-103 Requirements for NASA Awards \*\***

In general, DCAA will perform all audit work requested by NASA when NASA is designated as either the cognizant or oversight agency for audit or indirect costs. See 15-106 for guidance related to performing audit services for NASA awards. The NASA Office of Inspector General (OIG) staff will coordinate with DCAA on desk reviews or quality control reviews they performed and provide input to DCAA for the Uniform Guidance audit. DCAA will provide the NASA OIG staff access to Agency working papers at all locations. DCAA will forward issues identified by NASA to the DoD OIG for their consideration when carrying out responsibilities for overseeing DCAA's audit work.

### **13-104 Organized Research \*\***

a. DCAA audits of educational institutions and nonprofits are generally performed with a focus on the organized research major function for research and development awards. Organized research can be performed at educational institutions, FFRDCs, and other nonprofit organizations.

b. Activities that support organized research include programming, recruiting, supervising sponsored research, and engaging in the administration of sponsored agreements.

c. Where organized research is performed in a separate facility with its own administrative organization, the auditor will need to evaluate the allocation of indirect costs to determine the appropriateness of the allocations. For example, if the separate facility has its own accounting personnel working for the organization, it should not receive a pro-rata allocation of these types of cost from the overall institution's accounting function.

d. The auditor should perform procedures necessary to evaluate the allocation of indirect costs, such as departmental administration expense, general administration and general expenses, etc., to determine if:

- the organized research function is receiving an equitable share of those costs based on the benefits received from the activities, and
- the costs are allocated in compliance with 2 CFR 200, subpart E and applicable appendices (appendix III for IHEs, and appendix IV for nonprofits)

### **13-200 Section 2 - Coordination and Communication \*\***

a. Throughout each audit assignment, auditors should maintain effective and timely communication with Government contract/grant personnel on significant matters. See 4-100 for guidance related to communication and interfacing with Government personnel and the auditee organization.



b. If the regional or corporate audit directorate FAO does not have access to Federal awards because they are classified, audit assistance from the cognizant Field Detachment FAO should be requested. When regional or corporate audit directorate and Field Detachment FAOs have joint audit responsibilities, the objective is to achieve a comprehensive, coordinated, and integrated audit. Annual coordination meetings should be held between the FAOs to determine their respective responsibilities (see 6-405.4a). The coordination activities between the regional or corporate audit directorate FAO and the Field Detachment FAO should be documented in the working papers.

### **13-300 Section 3 - Federal Regulations [\\*\\*](#)**

#### **13-301 Title 2 of the Code of Federal Regulations, Part 200 (Uniform Guidance) and FAR [\\*\\*](#)**

a. The Uniform Guidance establishes the cost principles for determining allowable costs at nonprofit organizations, IHEs, state and local governments, and Indian Tribal governments. (see Non-Federal Entity, recipient and subrecipient definitions under [§200.101](#)). [§200.101](#) Applicability, identifies the following types of awards that are subject to the Uniform Guidance cost principles in Subpart E:

- grants,
- cooperative agreements, and
- all procurement contracts awarded under FAR (including any subcontracts issued thereunder by the Prime).

Auditors should review the terms and conditions of awards and any modifications to determine the criteria governing allowability of cost, including any applicable agency regulations related to grants. For example, the Department of Defense regulations governing grants and agreements are located at [32 CFR subchapter C](#), and the Department of Energy Assistance Regulations are located in [10 CFR 600](#).

b. Nonprofits and IHEs that expend Federal awards of \$1,000,000 or more during the fiscal year, as either a recipient or subrecipient, must have an annual single audit performed in accordance with 2 CFR 200, subpart F. See [section 800](#) for discussion the Single Audit requirements.

#### **c. [FAR 31.3](#) - Contracts with IHEs**

(1) [FAR 31.303](#) states that contracts that refer to FAR 31.3 for determining allowable costs under contracts with IHEs shall have allowability of costs determined by 2 CFR 200, subpart E and appendix III in effect on the date of the contract.

(2) The Uniform Guidance at 2 CFR 200 superseded OMB Circular A-21 for new awards issued after December 26, 2014. Awards issued prior to December 26, 2014, remain subject to the OMB Circular A-21 until modification of the award incorporates the Uniform Guidance, Subpart E. When FAR 31.3 is referenced in the award terms and conditions, the auditor will need to consider the date of the award, and review the terms and conditions of the award and its modifications to determine whether OMB Circular A-21 or 2 CFR 200, Subpart E and appendix III applies.

#### **d. [FAR 31.7](#) - Contracts with Nonprofit Organizations**

FAR [31.703](#) states that contracts that refer to FAR 31.7 for determining allowable costs shall have the allowability of costs determined in accordance with 2 CFR 200, subpart E and appendix IV in effect on the date of the contract. Awards issued prior to December 26, 2014 remain subject to OMB Circular A-122 until modification of the award incorporates the Uniform Guidance, subpart E and appendix IV. The auditor will need to consider the date of the award, and review the terms and conditions of the award and its modifications to determine whether OMB Circular A-122 or 2 CFR 200, subpart E and appendix IV applies. Agencies are not expected to place additional restrictions on individual items of cost but situations may occur when this happens. However, [FAR 31.703\(b\)](#) identifies the costs cited in [FAR 31.603\(b\)](#) that are unallowable.

e. [FAR 31.6](#) – Contracts with State, Local, and Federally Recognized Indian Tribal Governments. FAR [31.603](#) states that contracts that refer to FAR 31.6 for determining allowable costs shall have the allowability of costs determined in accordance 2 CFR 200, subpart E and appendices V and VII in effect on the date of the contract. Additional costs are identified as unallowable on contracts to these types of entities. The cost principles are for cost determinations, not to identify or dictate the extent of Federal and State or local participation in financing a particular contract.

(1) The Uniform Guidance at 2 CFR 200 superseded OMB Circular A-87 for new awards issued after December 26, 2014. Awards issued prior to December 26, 2014 remain subject to OMB Circular A-87 until modification of the award incorporates the Uniform Guidance, subpart E and appendices V and VII.

(2) FAR does not explicitly state that contracts referring to FAR 31.6 are subject to the Uniform Guidance, therefore, the auditor will need to consider the date of the award, and review the terms and conditions of the award and its modifications to determine whether OMB Circular A-87 or 2 CFR 200, subpart E and appendices V and VII applies.

### **13-302 Uniform Guidance Cost Principles \*\***

a. Uniform Guidance establishes a single set of cost principles for all types of non-Federal entities in [2 CFR 200 Subpart E](#). When testing for allowability of cost, auditors should carefully consider specific cost principles to determine the appropriate criteria. Certain types of cost that are unallowable for commercial (for-profit) contractors may be allowable with restrictions for universities and nonprofit organizations. Additionally, some of the cost principles contain different requirements depending on the type of non-Federal entity. The Compliance Supplement is published by OMB and is available on the [Federal Audit Clearinghouse](#) website. (Select “Quick Links” on the right and then select “Resources”.)

b. Because some of the cost principles have specific criteria depending on the type of organization, auditors should ensure they understand the entity’s organizational type.

(1) When the Uniform Guidance refers to an Institution of Higher Education, it means an entity as defined at [20 USC 1001](#). An educational institution is one that regularly admits students for post-secondary education, where students have a certificate of secondary education (high school diploma or GED or equivalent recognized certificate). To be considered an educational institution, the institution must award a bachelor’s degree, or a degree that is not less than a 2-year program that is acceptable for full credit toward such a degree.

(2) When the Uniform Guidance refers to a nonprofit organization, it means any

corporation, trust, association, cooperative, or other nonprofit organization that is not an institution of higher education ([2 CFR 200.70](#)) that is:

- operated primarily for scientific, educational, service charitable, or similar purposes in the public interest,
- is not organized primarily for profit, and
- uses net proceeds to maintain, improve, or expand the organization's operations.

A nonprofit organization may provide certificates, or may work with IHEs to enable students to earn credits towards their bachelor's or graduate degrees at the school where the students are enrolled for the degree. For example, nonprofit research organization AAA awards certificates in biochemical research, and also works with A University to provide A University students opportunities to take classes or conduct research at AAA. The students earn credits through activities performed at AAA that count towards their A University degree. Because AAA does not, itself, offer a degree, such as an associate, bachelors or graduate degree, it is not an educational institution even if it works in conjunction with an educational institution.

### **13-302.1 Nonprofit Organizations \*\***

a. As discussed, when [FAR Subpart 31.7](#) is applicable, allowable costs will be determined by either the Uniform Guidance or Circular A-122 depending on when the award was issued, or modified. DCAA audit reports and correspondence should cite the cost principles incorporated in the agreement, i.e., either 2 CFR 200 or OMB Circular A-122, as the authoritative regulation, **not** FAR Part 31.

b. 2 CFR 200, [Appendix VIII](#) provides a list of nonprofit organizations that are exempt from the Subpart E cost principles. Additionally, OMB may provide exemption from the Uniform Guidance cost principles to nonprofit organizations on a case-by-case basis. If a nonprofit organization claims exemption from the Uniform Guidance, Subpart E cost principles, auditors should verify that OMB has provided the exemption.

c. For audit guidance common to both nonprofit organizations and IHEs see [section 500](#). For additional guidance specific to audits at nonprofit organizations see [section 600](#).

### **13-302.2 Educational Institutions (IHE) \*\***

a. As discussed, when [FAR Subpart 31.3](#) is applicable, allowability of costs are determined by either the Uniform Guidance, Subpart E, or Circular A-21 depending on when the award was issued, or modified. DCAA audit reports and correspondence should identify the cost principles incorporated in the agreement, i.e., 2 CFR 200 or OMB Circular A-21, as the authoritative regulation, **not** FAR Part 31.

b. For audit guidance common to both nonprofit organizations and IHEs see [section 500](#). For additional guidance specific to audits at IHEs see [section 700](#).

### **13-302.3 State and Local Governments and Indian Tribal Governments \*\***

a. As discussed, when [FAR Subpart 31.6](#) is applicable, the allowability of costs will be determined by either the Uniform Guidance or Circular A-87 depending on when the award was issued, or modified. DCAA audit reports and correspondence should identify the cost principles incorporated in the agreement, i.e., 2 CFR 200 or OMB Circular A-87, as the authoritative regulation, **not** FAR Part 31.

b. DCAA does not generally perform audits on state and local governments or Indian tribal governments. This chapter does not provide specific guidance related to these types of organizations. Auditors performing audits at these entities should consult with their technical specialists and Regional Technical Programs (RST) divisions as needed.

### **13-303 Uniform Administrative Requirements for Federal Financial Assistance \*\***

a. The Uniform Guidance establishes the requirements for Federal agency and pass-through entity administration of Federal Financial Assistance such as grants, cooperative agreements, and other federal awards issued to IHEs and other nonprofit organizations in Subparts A through F.

Applicable to most types of Federal awards

- Subpart A - Acronyms and Definitions,
- Subpart B - General Provisions, and
- Subpart F – Audit Requirements

Applicable to grants and cooperative agreements (with exceptions noted):

- Subpart C - Pre-Federal Award Requirements and Contents of Federal Awards and
- Subpart D - Post Federal Award Requirements, Subrecipient Monitoring and Management

Exception: [2 CFR 200.101\(b\)\(3\)](#) states that [2 CFR 200.303](#) (Internal Controls) and [200.331-333](#) (Subrecipient Monitoring and Management) apply to all types of Federal financial assistance (to include contracts and subcontracts).

Applicable to grants, cooperative agreements, and cost-reimbursement contracts and subcontracts awarded under the FAR

- Subpart E – Cost Principles

See the Applicability table in [§200.101](#) for more information on the portions of the Subparts that are not applicable to administration of cost-reimbursement contracts awarded under FAR.

c. Auditors should consider the applicable Uniform Administrative Requirements of Subpart D, Post Federal Award Requirements, for post award financial and program management, property standards, procurement standards, performance and financial monitoring reporting, subrecipient monitoring and management, record retention and access, remedies for noncompliance, and closeout. Subpart D provides that pass-through entities, recipients and subrecipients must be in compliance with:

(1) Internal controls. [2 CFR 200.303](#) is applicable to all types of Federal Awards and requires the recipient or subrecipient to establish and maintain effective internal control over the Federal award to provide reasonable assurance that the non-Federal entity is managing the Federal award in compliance with Federal statutes, regulations, and the terms and conditions of the Federal award.

(2) Cost sharing. [2 CFR 200.306](#) establishes the standards for identifying the entity's level of cost sharing. Any shared costs and all contributions, including cash and third party in-kind contributions, must be accepted as part of the recipient's or subrecipient's cost sharing when the amounts meet the criteria provided for in the standard. The standard permits

unrecovered indirect costs be included as cost sharing only when the Federal agency gives prior approval. The standard also identifies how the value of property and services should be determined.

(3) Property Standards. [2 CFR §200.310 through .316](#) establish standards that govern the management and disposition of Government property.

(4) Procurement Standards. [2 CFR §200.317 through .326](#) establish the guidelines recipients and subrecipients must use when making procurements, and include requiring open competition consistent with the standard, methods of procurement to be followed, and performance of cost and price analysis. Recipients and subrecipients are [required to implement](#) the Uniform Guidance procurement standards for fiscal years beginning on or after December 26, 2017.

(5) Performance and Financial Monitoring and Reporting. [2 CFR 200.328 through .330](#) establishes the requirements that recipients and subrecipients must follow when submitting financial reports, monitoring and reporting program performance, and reporting on real property.

(6) Subrecipient Monitoring and Management. [2 CFR 200.331 through .333](#) is applicable to all types of Federal awards and establishes the requirements that pass-through entities must follow when making determinations about whether a lower tier entity receiving Federal funds is a subrecipient or contractor, and establishes requirements for pass-through entities to follow in managing subrecipients and providing fixed amount subawards up to \$500,000.

(7) Record Retention and Access. [2 CFR 200.334 through .338](#) establishes the requirements that recipients and subrecipients must follow in retaining records for 3 years following submission of their quarterly or annual financial report, transfer of any records having long term value to the Federal agency for extended periods, collection, transmission, and storage of information, and providing access to records by the Federal agency, pass-through entity, Inspector General, Comptroller General of the US, or authorized representatives.

(8) Remedies for Noncompliance. [2 CFR 200.339 through .343](#) establishes the steps, including Termination or Suspension of the Federal award, that the Federal agency or pass-through entity may implement if the recipient or subrecipient fails to comply with the US Constitution, Federal Statutes, regulations, or the terms and conditions of the Federal award.

(9) Closeout. [2 CFR 200.344](#) establishes the final reporting requirements that the recipients and subrecipients must follow to support closeout of the Federal award within 120 days after the conclusion of the period of performance (for recipients), and within 90 days after the conclusion of the period of performance (for subrecipients). Approval for extensions may be provided by the Federal agency when final indirect rates have not yet been settled.

(10) Post-closeout Adjustments and Continuing Responsibilities. [2 CFR 200.345 through .346](#) establishes that closeout of the Federal award does not limit or affect the Federal agency's or pass-through entity's rights to disallow costs, return, receive or collect remaining funds due, make financial adjustments, provide for Audit requirements in Subpart F, manage or disposition property, or ensure records retention requirements.

## **13-400 Section 4 - Indirect Cost (F&A) Rates – General Information [\\*\\*](#)**

a. The cognizant Federal agency for indirect costs negotiates and approves indirect cost rates for nonprofit organizations and IHEs on behalf of all Federal agencies. Indirect cost rates are

typically negotiated in advance of the periods they are used based on costs incurred in the most recently completed fiscal year (base year).

b. Indirect cost (Facilities and Administration (F&A)) rates are used to allocate indirect costs to major functions, and subsequently to final cost objectives. Indirect costs are classified as “Facilities” costs and “Administration” costs and the negotiated rates are “F&A rates”. A separate F&A rate is established for each major function using the regular method. When applicable, a simplified method is available for smaller entities, which establishes a single F&A rate to allocate indirect costs to all final cost objectives.

c. [Section 602](#) provides additional discussion on F&A rates for nonprofit organizations.

d. [Section 708](#) provides additional discussion on F&A rates for Universities.

e. During an audit of an organization’s indirect cost rates, regardless of the type of rate proposed, the auditor should determine if the costs included in the pools and bases are allowable, appropriately classified as direct or indirect cost, and are likely to result in equitable distribution of cost for the years the rate will be used.

f. Final F&A rates can be negotiated as one of the following type of rates: 1) predetermined, 2) fixed with carry-forward provisions, 3) provisional, or 4) final. In certain circumstances, an entity may choose to use a de minimis rate, which does not require a formal agreement with the cognizant agency for indirect costs. The following provides a brief overview of each type of rate:

(1) Predetermined Rates: Indirect cost rates applicable to a specific current or future period or periods. Typically, the rates are estimated using the organization’s actual cost experience in its most recently completed fiscal year (base year). Predetermined rates are not subject to adjustment for variances to actual cost experience in the periods in which the rates are applied. This type of rate is commonly used when there is a reasonable expectation, based on past experience, that the rate is not likely to exceed the rate that would result from the actual costs incurred during the year the rate is applied.

(2) Fixed Rates: Indirect cost rates with the same characteristics as predetermined rates; however, the difference between the costs recovered using the negotiated rate and the actual costs incurred during the period the rate is used, is carried forward as an adjustment to the rate computation negotiated for a subsequent period. This type of rate is also referred to as a “fixed rate with carry-forward provisions”. Fixed rates may be negotiated where predetermined rates are not considered appropriate, e.g., where the historical costs vary significantly from year to year, or there is insufficient history on which to rely on the likelihood of the base-year costs being reasonable representations of future years, or when the business base changes significantly from year to year.

(3) Final Rates: Indirect cost rates applicable to a specified past period which is based on the actual costs of the period. Once final rates are negotiated, they are applied to the costs of period in which the costs were incurred and are not subject to further adjustment.

(4) Provisional or billing rates: Temporary indirect cost rates applicable to a specified period used for funding, interim reimbursement, and reporting indirect costs on Federal awards pending the establishment of a negotiated rate for the period.

(5) De minimis rate: Recipients and subrecipients that have never received a negotiated indirect cost rate may elect to charge a de minimis rate of 15 percent of the modified total direct



costs. The de minimis rate may be used indefinitely as long as the entity does not receive a negotiated indirect rate ([2 CFR 200.414\(f\)](#)). Non-Federal entities described in 2 CFR 200, Appendix VII (states, local governments, and Indian tribes) cannot use the de minimis rate.

g. Auditors must consider the requirements included in the appropriate Appendix to 2 CFR 200 that govern the development and negotiation of indirect rates for the type of entity under audit:

- (1) Nonprofit Organizations: [Appendix IV](#)
- (2) Educational Institutions: [Appendix III](#)
- (3) States, Local Government and Indian Tribes: [Appendix VII](#)
- (4) State and Local Government-wide Central Service Cost Allocation Plans: [Appendix V](#)

h. Impact of Single Audit Act. When Federal agencies require audits in addition to the annual single audit, those audits must be planned in a manner to avoid duplicative efforts of the audits of Federal awards ([2 CFR 200.503](#)). If the single audit has been completed for the fiscal year associated with the costs of the base-year included in the proposal, auditors should verify with the requestor that the single audit does not meet their needs. Further, they should consider the audit procedures performed for the single audit and any findings reported. This may require obtaining access to the independent accounting firm's (i.e., the IPA or State Auditor's Office as applicable) working papers to determine if the procedures performed were sufficient for the needs of the audit of the proposed indirect rates, and determining whether to use that audit work, following the guidance in [4-1000. 2 CFR 200.517\(b\)](#) requires audit documentation be made available upon request to the cognizant or oversight agency for audit or its designee and the auditor should coordinate through the Cognizant Federal Agency for Indirect Costs for access to the IPA documentation.

## **13-500 Section 5 - General Audit Concepts - Universities and Nonprofit Organizations \*\***

### **13-501 Introduction \*\***

This section provides general concepts common to audits at both universities and nonprofit organizations, including audits of cost allowability, development of indirect cost rates, and evaluation of related management policies, procedures, and practices. The audit team needs to carefully review the terms and conditions of grants, agreements, and contracts awarded to the entity to determine the applicable criteria against which to test costs for allowability, allocability, reasonableness, and compliance with other terms and conditions of the awards.

- Additional guidance related to audits at nonprofit organizations can be found in [section 600](#).
- Additional guidance related to audits at IHEs can be found in [section 700](#).

### **13-502 Audit Objectives \*\***

a. The audit objectives in the DCAA audit of university and nonprofit organizations is to determine if costs included in claims, proposals, and financial reports under Federal awards are reasonable, fairly presented, appropriately charged or allocated, and determined in accordance with the terms and conditions of the awards and applicable regulations.

- b. [CAM 6-600](#) provides general guidance in establishing the scope of audit and performing

audits of indirect costs. Although the discovery of fraud or other unlawful or improper activity is not the primary audit objective, the auditor must be attentive to any condition which suggests that such a situation may exist. If such activity is suspected, the circumstances should be reported in accordance with [4-700](#). The audit objectives are to evaluate and determine the following:

- (1) allowability, allocability, and reasonableness of the costs charged to Federal awards,
- (2) appropriateness of the bases and the methods used to allocate indirect costs to Federal awards,
- (3) appropriateness of the indirect cost period,
- (4) consistency of the application of policies and procedures to the Government and to other operations, and
- (5) mathematical accuracy of the computed indirect cost rates.

### **13-503 Cost Accounting Standards (CAS) \*\***

a. The rules and regulations of the Cost Accounting Standards Board are contained in 48 CFR 99. The CAS applicable to IHEs differs from the CAS applicable to other nonprofit and commercial organizations.

- Applicability of CAS to nonprofit organizations is in [section 601](#).
- Applicability of CAS to Universities is in [section 704](#).

### **13-504 Audit Planning \*\***

a. To adequately plan the audit, the auditor should obtain a sufficient understanding of the organization and its internal controls that significantly impact the subject matter during the risk assessment to determine the timing, extent, and nature of audit procedures required to reach a conclusion on the subject matter. To assist in designing audit procedures to achieve the audit objective, the auditor should:

- (1) Review relevant information included in the auditee's permanent files in accordance with [4-405](#).
- (2) Obtain and review relevant organizational policies and procedures to gain an understanding of the organization, the adequacy of the policies, identification of key internal controls, reliability of the accounting system, etc.
- (3) Review a listing of open awards and the award briefs to understand the type of work performed, the materiality of various programs, applicable criteria (e.g., FAR Part 31, 2 CFR 200, subpart E, OMB Circular A-21, etc.), and whether any special terms and conditions are in place. (See Audit Criteria section below).
- (4) Obtain and review any advance agreements or memoranda of understanding that are relevant to the subject matter.
- (5) Classified grants and contracts awarded to a University or Nonprofit organization need to be coordinated with Field Detachment (FD). The FD audit team should carefully brief the classified grant or contract for unique terms and conditions and applicable criteria.

#### **b. Audit Criteria**

To determine overall applicable criteria to sections of the 2 CFR 200, the audit team must

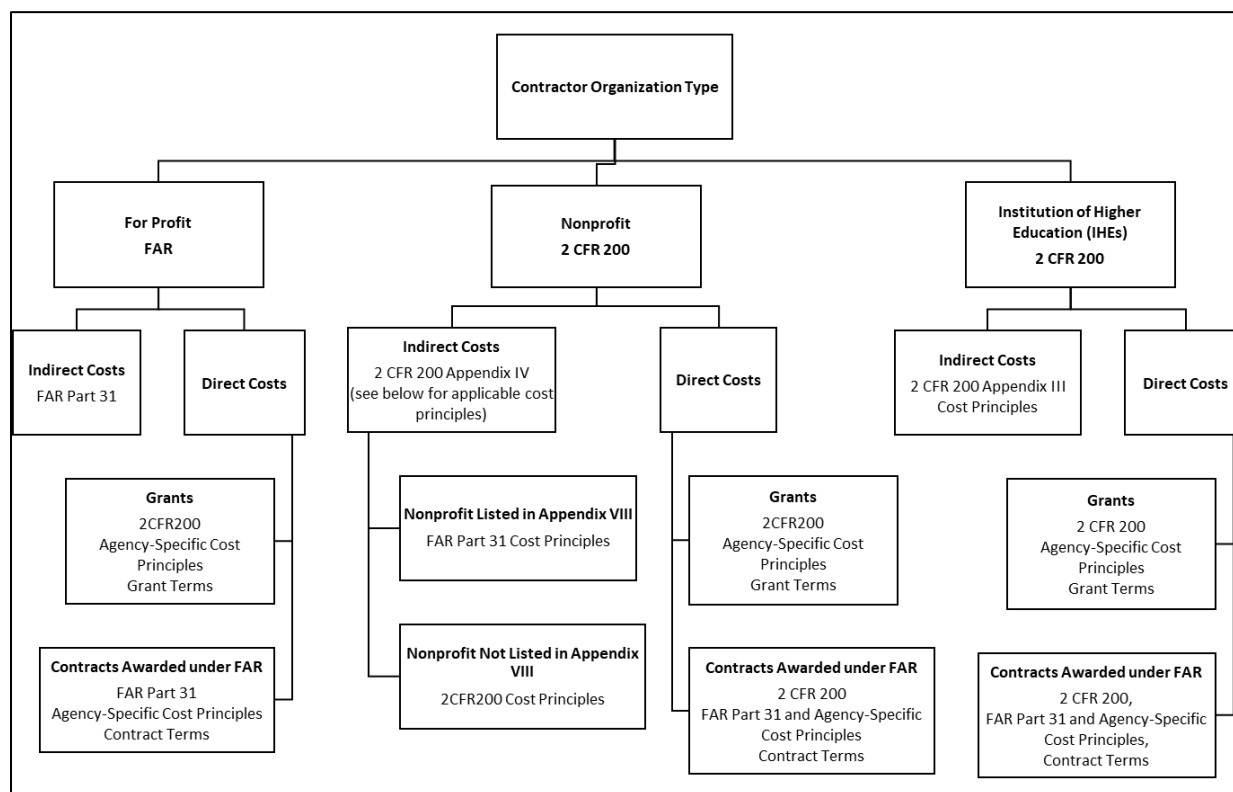


first determine the nature of the contractor: For Profit, Nonprofit, or an Institute of Higher Education (IHE). While For-Profit Organizations are not considered “non-Federal entities” as defined in 2 CFR 200, Federal Agencies may apply these requirements to them (§200.101(c)) as these entities may be awarded grants. (See Figure 13-5-1 for an illustration of the regulations applicable to different types of Federal Awards). In addition to the regulations, the audit team needs to determine CAS applicability. To the extent that CAS is applicable, the allocation of costs to contracts and subcontracts in accordance with CAS takes precedence over the allocation provisions in 2 CFR 200 ([2 CFR 200.405\(e\)](#)). For CAS applicability see 13-600 for nonprofits and 13-700 for IHEs.

### c. Accounting Systems

Auditors should evaluate the organization’s accounting system, related administrative policies and procedures, and internal key controls to determine if the system is adequate to comply with terms and conditions of awards and applicable regulations.

**Figure 13-5-1 Illustration – Criteria Applicability \*\***



### 13-504.1 Review of Organization’s Policies \*\*

a. Understanding relevant organizational policies and procedures is necessary to determine if the organization’s accounting system provides for proper recording of costs. The auditor should review relevant policies to determine if the established procedures enable the organization’s staff to ensure indirect costs are equitably allocated, provide instruction for determining allowability of cost for a given type of Federal award or contract, and enable staff to appropriately identify and isolate unallowable costs and preclude them from billing on Federal awards.

b. The auditor should review the organization's policies related to development of the budget to determine if the organization has policies in place to ensure prior approvals are obtained when required for budgeting and re-budgeting expenditures.

c. The auditor should review other organizational policies related as necessary, based on the risk identified. This could include policies on cost sharing, subrecipient monitoring, procurement activities, etc.

#### **13-504.2 Cost Sharing \*\***

a. Audit effort should focus on determining if the organization properly accounts for its cost-sharing obligations in accordance with [2 CFR 200.306](#), which includes the requirement that the Federal agency or pass-through entity must accept any cost sharing funds under the cost principles and the terms of conditions of awards with the cost-sharing provisions.

b. The auditor should determine if adequate internal control is established to ensure the organization meets its cost-sharing obligations. Audit activities might include:

(1) Identifying key internal controls, such as internal edit checks in the accounting software that trigger notification to responsible individuals when the required contribution for an award is different (i.e. more or less) than the amount budgeted, or monthly reviews by responsible individuals (budget or program performance personnel, for example) to determine if the organization is on-target to meet contribution requirements.

(2) Designing audit procedures to test the effectiveness of key controls, such as observation of internal edit checks, or verification that appropriate personnel completed monthly reviews of contribution levels with timely action taken as needed.

c. The auditor should determine if cost-share contributions were charged to at least one Federal award (either directly or indirectly) in the current and preceding fiscal year, and that the contribution was from a non-Federal source.

#### **13-504.3 Use of Statistical Sampling \*\***

a. The audit program should be designed to maximize the use of audit techniques that increase the efficiency and effectiveness of the audit, including use of statistical sampling when appropriate. See [4-600](#) for guidance on audit sampling and other analytical procedures in audits. For complex applications of statistical sampling, the DCAA [Technical Audit Services Support \(OTS\)](#) can provide assistance.

b. In general, all Federal awards affected by the scope of audit should be considered as part of the audit universe for purposes of sampling, including awards that are grants, cooperative agreements, or contracts, and both DoD and non-DoD funded. The sampling frame is dependent on the specific criteria being tested, the auditor's understanding of internal control over that criteria, and the assessed risk. Sampling plans should be designed to permit effective testing of the specific characteristic of the universe in order to meet audit objectives. For example, if the auditor is testing for compliance with the use of negotiated labor rates in billings, the sample universe would only include contracts that have negotiated labor rates; the sample universe would not include contracts where labor is paid based on progress.

c. In order to develop sound audit recommendations and follow-up actions, the results of the testing performed on a statistical sample must be appropriately evaluated. Results of testing may indicate such things as a procedural or internal control weakness, inaccurate or unreliable

records, errors that are isolated to the individual transactions or the individual award from which the item was selected, errors that indicate systemic or pervasive issues, etc.

#### **13-504.4 Audit Procedures Specific to Grants and Cooperative Agreements [\\*\\*](#)**

a. Establishing audit procedures for audits of grants and cooperative agreements is the same as designing procedures to audit other types of contracting instruments. The auditor needs to clearly identify the relevant criteria for measuring the results of testing and analytical procedures. The auditor should modify the standard audit program as necessary for the subject matter in order to meet the objectives of the audit. For example, modifications would be required when procedures have indicated that the organization's practice of allocating indirect costs result in inequitable cost allocation to grants, or when errors are observed during tests of internal control effectiveness that indicate an inadequacy of the accounting or billing system (For indirect cost see 13-506).

#### **13-504.5 Reporting – General Information [\\*\\*](#)**

Audit reports should only include information for grants, contracts, and cooperative agreements for awards funded by the DoD or for non-DoD agency where an inter-agency agreement for DCAA to perform audits has been signed. In order for ONR to negotiate indirect cost rates, however, the audit universe should include all awards. If audit procedures indicate a significant deficiency or material weakness related to a non-DoD funded grant, follow the guidance in [15-102.2](#) for communicating the deficiency to the non-DoD agency. This may be required when, during performance of normal audit procedures, the auditor becomes aware of organizational deficiencies that have a significant effect on the cost of one or more grants of the non-DoD agency.

#### **13-504.6 US Agency for International Development (USAID) Awards [\\*\\*](#)**

a. The auditor needs to review USAID award terms and conditions to identify the applicable cost principles for the award. USAID awards that do not contain the CAS clause may contain special provisions for allowability of certain costs as direct costs although the costs would normally be considered an indirect cost.

b. The auditor should design audit procedures to determine if the organization has made appropriate adjustments to comply with special provisions of USAID awards.

#### **13-505 Audit of Direct Costs [\\*\\*](#)**

a. Direct costs are defined in 2 CFR 200.413(a) as “costs that can be identified specifically with a particular final cost objective, such as a Federal award, or other internally or externally funded activity, or that can be directly assigned to such activities relatively easily with a high degree of accuracy”. The ability to identify the benefit to the work, rather than on the nature of the goods or services, is the determining factor in distinguishing between direct and indirect costs.

b. Awards issued prior to the implementation of 2 CFR 200 on December 26, 2014 may still be subject to the conditions under the OMB Circular A-122 for Nonprofits, OMB Circular A-21 for Educational Institutions, and OMB Circular A-87 for state, local and Indian Tribal Governments, so the auditor must ensure to determine the appropriate criteria when testing direct cost to a Federal award.

### **13-505.1 Audit Objective \*\***

The primary audit objective is to express an opinion on the organization's cost representations as to whether the costs are reasonable, allocable to the Federal award, and allowable, as determined by applicable cost principles, cost accounting standards (CAS) applicable in the circumstances, not prohibited by the Federal award, by statute or regulation, or by previous agreement with, or decision of, the cognizant federal agency official as well as under appropriate generally accepted accounting principles (GAAP),.

### **13-505.2 Basic Audit Procedures for Testing Direct Cost \*\***

a. [Chapter 6, Incurred Cost Audit Procedures](#) provides guidance in performing audit procedures on incurred direct costs. When testing direct cost at a nonprofit organization or an IHE, the auditor should specifically consider the guidance in 6-300, Audit of Incurred Material Costs and Purchased Services, 6-400, Audit of Incurred Labor, 6-500, Audit of Incurred Other Direct Costs and Credits.

b. Auditors should perform procedures to determine if the organization complied with the awarding agency's requirements established for the Federal program, the terms and conditions of the award, and applicable laws and regulations including if the costs are allowable under the applicable cost principles, Federal statutes and regulations, and terms and conditions of the awards. If tests disclose instances of internal control deficiencies, unallowable cost, or inaccuracies in recording, the auditor should design and perform additional tests as necessary to obtain sufficient evidence to reach a conclusion regarding the nature, timing, and extent of the deficiencies, for example whether the observed errors or deficiencies are isolated to the specific item, the related Federal award, or represent a pervasive condition.

c. Statistical sampling may be an effective and efficient method to select a sample for testing direct cost in order to reach a conclusion on the universe (see 504.3).

d. If the organization uses any special distribution methods to allocate direct costs, the auditor should determine if the distribution is equitable and appropriately allocated to benefiting cost objectives.

### **13-505.3 Intermediate Direct Cost Pools \*\***

Direct costs for related awards may be accumulated as intermediate cost objectives with subsequent allocation of the direct costs to the individual awards. The organization may have special facilities, or scientific discipline-level projects, for example, and accumulate direct costs, such as salaries and wages, common materials and supplies, etc. in an intermediate direct cost pool for allocation to the awards in the project. When an organization uses an intermediate direct cost pool, audit procedures should be performed to determine the following:

- Allocation of the direct costs results in an equitable distribution of cost to the individual awards,
- Consistency of treating similar common costs by the same distribution methods in like circumstances, and
- The organization's compliance with any limitations or exclusions of cost required by individual agreements. Auditors should determine if costs are first appropriately allocated to the benefiting awards before the cost limitations are applied so that any

costs over the limitation on a specific award are not allocated to another award.

### **13-506 Audit of Indirect Costs – Universities and Nonprofit Organizations \*\***

Implementation of the Uniform Guidance at 2 CFR 200 streamlined and consolidated the requirements related to grants and other types of financial assistance to nonprofits, universities, and state and local governments. The information provided in this section is applicable to all audits at both nonprofit organizations and universities. See sections [600](#) and [700](#) for considerations specific to nonprofit organizations and universities respectively.

#### **13-506.1 Introduction – Facilities and Administration Costs \*\***

a. After identifying and distributing direct costs, indirect costs must then be grouped into cost groupings, or pools, for allocation to major activities and functions. “Facilities” and “Administration” are the two overarching indirect cost categories ([2 CFR 200.414](#)). Within these two broad categories, subcategories of certain types of cost must be treated as specific cost groupings. A cost grouping is a pool of expenses that are of like nature in terms of the relative contribution to the allocation base (2 CFR 200, [Appendix III](#), Section A.2.b for universities, and [Appendix IV](#), Section B.3 for nonprofit organizations)).

b. Major nonprofits and IHEs (organizations that receive more than \$10 million in direct Federal funding (2 CFR 200.414(a)) are required to use the Standard Format to classify their indirect costs into one of the two overarching categories, either facilities or administration (F&A). Then, generally using a step-down process, the costs are aggregated for each major function. See [section 602.4.2](#) and [section 708.5](#) for additional guidance related to F&A cost groupings for nonprofit and universities respectively.

c. Smaller organizations, with less than \$10 million in Federal funding, may be able to use a simplified method to allocate indirect costs to final cost objectives. See [section 602.4.1](#) and [section 712.2.1](#) for indirect cost groupings using the simplified method for nonprofit organizations and universities, respectively.

d. The Uniform Guidance identifies specific types of cost that must be classified into the subcategories within the F&A categories. There are some differences in how costs are classified for universities versus nonprofit organizations, and the auditor should review [section 602.3](#) and [section 708.5](#), as applicable, to the type of entity under audit.

e. Auditors should determine if costs are grouped in the appropriate cost groupings, in accordance with the requirements of the Uniform Guidance and have similar causal or beneficial relationships with the allocation base.

#### **13-506.2 Distribution of F&A Cost Groupings – Overview \*\***

a. This section provides a high-level overview of the order of distribution (also referred to as the “step-down process”) required by 2 CFR 200. The Uniform Guidance Appendices prescribe that indirect facilities cost be distributed to each major function in a specified order to ensure the costs included in the earlier distribution receive their share of the costs in the later distributed costs. This method must be used unless a simplified method is appropriate, or another method is demonstrated to result in more equitable distribution of cost. The order of distribution of indirect cost groupings is the same for major IHEs ([Appendix III](#), Section A.2.e) and major nonprofit organizations ([Appendix IV](#), Section B.3.d), and must be distributed to other indirect cost groupings and major functions in the following order:

(1) Depreciation cost is distributed in the following order based on the asset type:

- i. Buildings used exclusively for a single function,
- ii. Buildings used for more than one function,
- iii. Buildings used jointly by more than one function, and
- iv. Capital improvements that are not included in the cost of buildings.

(2) Interest on debt associated with certain buildings, equipment and capital improvements, as defined in [§200.449](#), must be classified as an expenditure under the facilities cost category. Interest costs are allowable provided they are compliant with regulation, and allocated in the same manner as the depreciation on the buildings, equipment and capital improvements to which the interest relates.

(3) Operation and maintenance (O&M) costs include costs normally incurred for items such as: janitorial and utility services; repairs and ordinary or normal alterations of buildings, furniture and equipment; care of grounds; maintenance and operation of buildings and other facilities; security; hazardous waste disposal; property, liability and other insurance relating to property; space and capital leasing; facility planning and management; and central receiving.

(4) General administration (GA) costs are defined as general administrative and general expenses and include indirect costs such as the President's or Chancellor's office, accounting personnel and all other types of expenditures not listed specifically under one of the subcategories of "facilities".

### **13-507 Selected Areas of Cost [\\*\\*](#)**

#### **13-507.1 Introduction [\\*\\*](#)**

a. The Uniform Guidance cost principles specified in 2 CFR 200, Subpart E provide the guidelines for determining cost allowability on Federal awards to recipients and subrecipients such as nonprofits and IHEs. FAR Part 31 cost principles are applicable to the nonprofit organizations listed in [2 CFR 200, appendix VIII](#).

b. While most of the cost principles contain criteria that apply to all types of nonprofit, IHEs, states, local governments, and Indian Tribes, some of the cost principles contain criteria specific to an entity type. Where criteria differs for a particular type of entity, the cost principle specifically identifies the requirements for that type of entity.

c. See [section 603](#) for criteria specific to nonprofit organizations.

d. See [section 713](#) for criteria specific to IHEs.

e. Auditors should carefully review each cost principle in 2 CFR 200, subpart E, to ensure use of the appropriate criteria for the type of entity under audit.

#### **13-507.2 Equipment and Other Capital Expenditures [\\*\\*](#)**

a. The capitalization threshold for equipment is \$10,000 or the capitalization levels established for financial statement purposes, whichever is less. The auditor should determine if the entity appropriately capitalized equipment and other capital expenditures.

b. When equipment costs are charged directly, the auditor should perform procedures to determine if the entity appropriately applied the rules prescribed by [§200.439](#):



(1) Capital expenditures for general purpose equipment, buildings, and land are unallowable as direct charges except with prior written approval of the Federal agency or pass-through entity.

(2) Capital expenditures for special purpose equipment are allowable as direct costs, provided the items with a unit cost of \$10,000 or more have the prior written approval of the Federal agency or pass-through entity.

(3) Capital expenditures for improvements to land, buildings, or equipment that materially increase the value or useful life of the asset are unallowable as a direct cost except with prior written approval of the Federal agency or pass-through entity.

(4) When approved as a direct charge, capital expenditures will be charged in the period in which the expenditure is incurred, or as determined appropriate and negotiated with the Federal agency.

c. The unamortized portion of any equipment written off as a result of a change in capitalization levels may be recovered by continuing to claim the otherwise allowable depreciation on the equipment, or by negotiating with the Federal agency to amortize the amount to be written off over a period of years.

d. If the entity is instructed by the Federal awarding agency to otherwise dispose of or transfer the equipment, the costs of the disposal or transfer are allowable.

### **13-507.3 Depreciation Expense \*\***

a. Depreciation expense compensates the organization for the loss in asset value related to consumption of the asset. Allowability of depreciation expense is covered in [2 CFR 200.436](#). For assets acquired after December 26, 2014, the Uniform Guidance requires the use of depreciation to recover costs for an asset (a use allowance is not permitted) over the asset's useful life.

b. Capital expenditures for general purpose equipment, buildings, and land are unallowable as direct charges except with the prior written approval of the Federal awarding agency or pass-through entity ([2 CFR 200.439](#)).

c. Assets must be depreciated in accordance with GAAP, provided that the assets are used, needed in the activities, and properly allocated to Federal awards. The entity must use the same depreciation methods as used for its financial statements. Additionally, the method selected for depreciation of an asset or class of assets may not be changed unless approved in advance by the cognizant agency. The auditor should verify that the depreciation method is acceptable under GAAP, that the method of depreciation is the same for both charging Federal awards and reporting in the financial statements, and that the depreciation charges to Federal awards is related to assets that meet these criteria.

d. The auditor should verify that depreciation expense is based on the acquisition cost of the assets involved and that the acquisition cost excludes the following:

- (1) The cost of land,
- (2) Any portion of the cost borne or donated by the Federal government,
- (3) Any portion of cost contributed by or for the recipient or subrecipient where law or agreement prohibits recovery, and

(4) Any asset acquired solely for the performance on non-Federal awards.

e. For donated assets, the fair market value at the time of the donation must be considered as the acquisition cost. The auditor should verify that the asset value is based on the value at the time the asset was donated. Donated assets may be used to meet matching requirements or depreciated, but not both. Because assets may remain in use for many years, the auditor should verify that depreciation charges to Federal awards for donated assets were not initially used to meet matching requirements.

f. A building, including the shell and all components, may be treated as a single asset, or it may be divided into multiple components for the purpose of depreciation. If treated separately, each component item may be depreciated over its estimated useful life. The building components, unless authorized by the cognizant agency, must be grouped into three general components: 1) the building shell (including construction and design costs), 2) building services systems (such as elevators, HVAC, plumbing systems, heating and air-conditioning systems), and 3) fixed equipment (such as sterilizers, fume hoods, glassware, etc.).

g. To compute depreciation expense the following conditions must be observed:

(1) The auditor should verify that the organization appropriately assessed the useful lives for an asset or class of assets. In establishing the estimated useful life, the organization should consider factors such as: the type construction, nature of equipment, technological developments in the particular area, historical data, and the renewal and replacement policies followed for the individual items or classes of assets involved.

(2) The depreciation method selected to charge cost of an asset or group of assets to accounting periods must reflect the pattern of consumption of the asset during its useful life. The straight-line method is presumed to be the appropriate method for depreciation unless clear evidence indicates that the expected consumption of the asset will be significantly greater in the early portions of the useful life. The auditor should evaluate material depreciation cost charged using other than the straight-line method and determine if the use of a different depreciation method is reasonable and results in equitable allocation.

(3) Depreciation cost on fully-depreciated assets is unallowable.

(4) Where the depreciation method is introduced to replace the use allowance method, depreciation must be computed as if the asset had been depreciated over its entire life. In these situations, the auditor should verify that the organization appropriately applied the depreciation method for the entire service life of the asset, not from the beginning of the depreciation method.

(5) The total amount of recovery from either depreciation or the use allowance method (including imputed depreciation applicable to periods prior to conversion from the use allowance method) may not exceed the total acquisition cost of the asset.

h. Depreciation charges must be supported by adequate property records and depreciation records that show the amount of depreciation taken each period. A physical inventory must be taken at least once every two years to ensure that the assets exist and are usable, used, and needed. Inventories may be based on samples or portions of the asset inventory, which may not cover every asset.

i. The auditor should verify the mathematical accuracy of the depreciation calculations and determine if the allocation to Federal awards is equitable.



j. For criteria specific to nonprofit organizations, see [section 604.4](#).

k. For criteria specific to IHEs, see [section 713](#).

#### **13-507.4 Interest \*\***

a. In general, nonprofit organizations and IHEs are encouraged to acquire assets in a manner that is least expensive, whether by lease or purchase. Interest may be allowable subject to the criteria for allowability of interest specified in [2 CFR 200.449](#).

b. Interest cost may be allowable or unallowable depending on the purpose for the interest (or financing) costs. If interest expense is considered material, the auditor should develop procedures to determine if the amount claimed is allowable in accordance with the cost principles and terms and conditions of the award.

c. Interest costs are unallowable when the interest is incurred on borrowed capital, or from the temporary use of endowment funds or the organization's own funds.

d. Financing (including interest) costs are allowable when incurred to acquire, construct, or replace capital assets subject to the conditions identified in §200.449.

e. If interest expense is considered material, the auditor should determine if the organization has entered into debt arrangements that exceed \$1 million to purchase or construct facilities. If so, perform procedures to determine if the organization complied with the requirements of §200.449(c)(7) in establishing the amount of interest claimed on the debt.

f. This cost principle is not applicable to nonprofits that are subject to full CAS coverage under the Cost Accounting Standards and the nonprofit must comply with CAS 414 and CAS 417 as applicable.

#### **13-507.5 Compensation for Personal Services \*\***

a. This section discusses allowability of compensation for personal services.

b. For additional criteria specific to nonprofit organization, see [section 604.2](#).

c. For additional criteria specific to IHEs, see [section 713.2](#).

##### **13-507.5.1 Audit Objective and Scope of Audit \*\***

a. [CAM Chapter 6](#) provides guidance for audits of incurred cost. See 6-400 for guidance applicable to the evaluation of incurred labor cost by area, identification of audit objectives and scope of audit for testing costs related to labor.

b. Accomplishment of the audit objectives will require consideration of each of the labor system areas listed in 6-401. The audit and the level of testing will be based on the control risk assessment and the vulnerability and materiality of the labor area involved. Substantive testing may be greatly reduced when the organization effectively maintains an adequate and compliant system of internal controls, including monitoring and testing of the system. Substantive testing should be focused in high risk areas.

##### **13-507.5.2 Compensation Criteria \*\***

a. The Uniform Guidance at [2 CFR 200.430](#) covers compensation. Compensation includes all remuneration, paid currently or accrued, for services of employees rendered during the period of performance under a Federal award. Compensation is not limited to wages and

salaries and may also include fringe benefits (see [§200.431](#)). See also specific guidance for fringe benefit costs in [section 507.6](#). Costs of compensation are allowable to the extent they comply with requirements of §200.430, and that the total compensation for individual employees:

(1) Is reasonable for the services rendered and conforms to established written policy of the organization and is consistently applied to Federal and non-Federal activities,

(2) Follows an appointment made in accordance with the organization's written policies and meets the requirements of Federal statutes, and

(3) Is determined and supported by the documentation requirements contained in §200.430(g).

b. The organization must follow its written entity-wide policies and practices related to the extent of professional services that can be provided outside the entity for non-organizational compensation (§200.430(c)). Where policies do not exist, the Federal government may require specific methodologies for allocating the cost of staff working on Federal awards.

c. Allowable compensation is limited to the compensation ceiling in accordance with applicable statutes.

d. Incentive compensation based on cost reduction or efficient performance, suggestion awards, safety awards, etc., is allowable to the extent that:

(1) overall compensation is determined to be reasonable, and

(2) costs are paid or accrued pursuant to an agreement entered into in good faith between the organization and the employees before services were rendered, or pursuant to an established plan followed by the organization so consistently as to imply an agreement to make payment.

### **13-507.5.3 Documentation Requirements for Compensation [\\*\\*](#)**

a. The Uniform Guidance provides guidelines for documentation to support compensation costs in the Standards for Documentation of Personnel Expenses at §200.430(i). The auditor should review the documentation guidelines in determining whether documentation supports that compensation costs are allowable, allocable and reasonable as charges to Federal awards.

b. Documentation required in §200.430(g) must be supported by records that indicate the total number of hours worked each day for non-exempt employees (§200.430(i)(3)).

c. Documentation must accurately reflect the work performed and be supported by a system of internal control that provides reasonable assurance that the charges are accurate, allowable, and properly allocated. Due to the intermingling of activities in academic settings, for example, a precise assessment of factors that contribute to costs is not always feasible or expected. Records may not be at a level of detail we commonly see in audits of for-profit organizations. For example, records may reflect categories of activities expressed as a percentage distribution of total activities.

d. Although there is no requirement to record time worked in any prescribed manner, documentation supporting compensation charges must:

- (1) Be incorporated into the official records of the organization,
  - (2) Reasonably reflect the total activity for which the employee is compensated and not exceed 100% of the compensated activities,
  - (3) Encompass both Federally-assisted and all other activities on an integrated basis, which may include the use of subsidiary records as defined in the organization's written policy,
  - (4) Comply with the organization's established accounting policies and practices,
  - (5) Support the distribution of the employee's salary and wages among specific activities or cost objectives if the employee works on more than one award, works in indirect and direct cost activity, or indirect activities where the cost is allocated differently, or in unallowable activities and allowable activities.
- e. Budget estimates alone do not qualify as adequate support for charges to Federal awards, but may be used for interim accounting purposes.

#### **13-507.5.4 Basic Audit Procedures \*\***

a. The auditor should determine the allowability of total compensation for individual employees and the reasonableness of the compensation costs for the services rendered by the employee and that the payments are compliant with Federal awards and applicable regulations, such as the Uniform Guidance cost principles and statutory compensation limitations. The auditor should obtain assistance from Government Technical Specialists or the Agency Compensation Team, as necessary, to determine reasonableness of total compensation to employees. See [Appendix B](#) for guidance in requesting specialist assistance.

b. The auditor should be alert to any condition that raises reasonable suspicion of unlawful or fraudulent activities, such as (1) payment of higher than normal wages for limited services provided by relatives of the entity's management, (2) key employees, or (3) for widely disparate services provided by an individual, for example, performing as a laboratory supervisor during the day, and also as a security guard during evenings and weekends.

c. The auditor should obtain and review the organization's policies related to personnel in order to gain an understanding of their practices for classifying personnel, for example, position qualification requirements, awarding promotions, establishing salaries and wages, and fringe benefits. The auditor should determine if:

(1) The policy is adequate to ensure compliance with the requirements of the cost principles, awarding agency policy, applicable regulations and laws, and terms and conditions of Federal awards.

(2) The amounts charged for personal services are based on the established organizational payroll system and documented in accordance with established practices and policies.

(3) The costs for compensation are adequately supported by documentation required by 2 CFR 200.430(g). For records that meet the standards established in §200.430(g)(1), no additional support or documentation is required for work performed.

d. The auditor should consider if expenditures for salaries are consistent with budgeted amounts and if significant changes to the budget were timely recorded and

appropriately reviewed and approved.

e. When the award terms and conditions, or an advance agreement under Federal award, provide for stipulated salary support, the auditor should verify that the stipulated salary amount is treated as a direct cost to the Federal award. Auditors are not required to verify the precise accuracy of time or effort devoted to research projects but should determine if the amount charged to Government-sponsored research is reasonable in view of the employee's other workload or commitments.

f. In addition to testing for general allowability and reasonableness of compensation costs, audit procedures should obtain evidence that salary charges for sponsored research agreements do not exceed a proportionate share of the employee's base salary.

### **13-507.6 Fringe Benefits \*\***

a. Allowability of cost related to fringe benefits is addressed in [2 CFR 200.431](#) and is discussed below. Except as provided elsewhere in the cost principles, the cost of fringe benefits are allowable provided they are reasonable and are required by law, an organization-employee agreement, or an established policy of the organization. Additional criteria specific to IHEs are discussed in [section 713.3](#).

b. The organization must have written policies on its fringe benefits practices. The auditor should review the written policies and determine if the policy complies with 2 CFR 200.431 and design audit procedures as necessary to determine if the fringe-related benefits costs are allowable and compliant with the requirements. The cost principle covers treatment of fringe benefits in sections .431(b) through .431(i), including the following:

- (1) compensated absence – (b)
- (2) employer contributions – (c)
- (3) assignment of cost to cost objectives – (d)
- (4) insurance – (e) (See also [2 CFR 200.447](#))
- (5) automobiles – (f)
- (6) pension plan benefits– (g)
- (7) post-retirement health benefits (h)

### **13-507.7 Cost of Audit Services \*\***

a. A reasonably proportionate share of costs of audits required by and performed in accordance with the Single Audit Act (31 U.S.C. 7501-7507, as implemented by the Uniform Guidance), are generally allowable, with exceptions under the cost principle at [§200.425](#) as follows:

(1) Costs for audits required by the Single Audit Act and 2 CFR 200, Subpart F, are unallowable when the audit has not been conducted or was not conducted in accordance with requirements.

(2) Costs of auditing a non-Federal entity that expends Federal awards less than \$1,000,000 during the fiscal year are unallowable. However, the costs of a financial statement audit of a recipient or subrecipient that does not currently have a Federal award may be included in the indirect cost pool for a cost allocation plan or indirect cost proposal. A pass-through entity

may charge Federal awards for the cost of agreed-upon-procedures engagements performed to monitor subrecipients.

## **13-600 Audits at Nonprofit Organizations \*\***

This section provides additional information for audits of nonprofit organizations that are not IHEs, FFRDCs, or state, local or Indian Tribal governments. This information is intended to complement the general guidance provided in sections 100 through 500 above. A nonprofit organization, per [2 CFR 200.70](#), is any corporation, trust, association, cooperative, or other organization, not including IHE, that operates primarily for scientific, educational, service, charitable, or similar purposes in the public interest, is not organized primarily for profit, and uses net proceeds to maintain, improve, or expand the operations of the organization.

### **13-601 Cost Accounting Standards \*\***

#### **13-601.1 Introduction \*\***

a. The Cost Accounting Standards Board's (CASB) rules and regulations applicable to nonprofits are implemented through 48 CFR 9903 and 9905 ([48 CFR 9903.201-2\(c\)](#)). CAS are rules that provide guidelines for how certain types of cost are to be allocated; it does not address allowability of cost.

b. A Federal contract (cost-reimbursement CAS-based contract subject to FAR) awarded to a non-Federal entity is subject to the Cost Accounting Standards (CAS).

c. When a contract with a nonprofit organization is subject to full CAS coverage, the allowability of certain costs under the cost principles will be affected by the allocation provisions of CAS. To the extent that CAS is applicable, the allocation of costs in accordance with CAS takes precedence over the allocation provisions in 2 CFR 200 ([2 CFR 200.405\(e\)](#)).

#### **13-601.2 Applicability \*\***

a. Grants and agreements awarded to nonprofits are not subject to CAS. Nonprofits can become subject to CAS if they are awarded a negotiated CAS-covered contracts and must comply with the applicable CAS for those CAS-covered contracts.

b. Unless the nonprofit organization is in one of the categories exempt from CAS under [48 CFR 9903.201-1](#), the organization may become subject to modified or full CAS coverage if awarded a negotiated CAS-covered contract. The applicability of CAS to nonprofit organizations is the same as the applicability to other for-profit organizations. The contracting officer should insert the appropriate CAS clause in the contract requiring compliance with the requirements of applicable CAS in 48 CFR 9904.

c. See [Chapter 8](#) for guidance and general information related to the Cost Accounting Standards Board, the requirements of CAS, and audit considerations related to CAS.

#### **13-601.3 Disclosed Practices (DS-1) \*\***

a. Nonprofit organizations must submit a disclosure statement (DS-1) when the conditions of [48 CFR 9903.202-1](#) are met.

b. If the organization is required to submit a DS-1, the auditor should verify that the cognizant agency for indirect rates has determined that the DS-1 is adequate and compliant and should design audit procedures to determine if the organization's actual practices are consistent

with its disclosed practices. The auditor should evaluate and report material noncompliances with CAS following the guidance in other sections of this manual, including 6-708.1(e), 6-709.2, 8-302.7, 10-208.7(e), and 14-120.2.

c. CAS noncompliances for negotiated CAS-covered contracts will be resolved by the cognizant Federal agency for indirect rates using the procedures in 48 CFR Part 30.

### **13-602 Establishing Indirect Cost Rates at Nonprofit Organizations (2 CFR 200, Appendix IV) \*\***

This section discusses various methods that Government agencies use to establish indirect cost rates at nonprofit organizations that are subject to the Uniform Guidance, and the audit responsibilities involved in the process. Small institutions that expend \$10 million or less in direct Federal funds in a fiscal year may elect to use simplified procedures to establish their indirect cost rates. The simplified procedures are discussed in section [602.4.1](#). The remainder of this section focuses on establishing indirect rates using the regular method.

#### **13-602.1 Audit Objective \*\***

[CAM 6-600](#) provides general guidance in establishing the scope of audit and performing audits of indirect costs. Discovery of fraud or other unlawful/improper activity is not the primary audit objective, but the auditor must be attentive to any condition which indicates that such a situation may exist. If such activity is suspected, the circumstances should be reported in accordance with [4-700](#). The audit objectives are to determine:

(1) allowability, allocability, and reasonableness of the costs charged to Federal awards. The Uniform Guidance provides definitions for these terms. See [§200.404](#) for the definition of reasonableness, [§200.405](#) for the definition of allocable costs, and [§200.403](#) for factors that affect allowability.

(2) propriety of the methods used to allocate indirect costs to Federal awards,

(3) appropriateness of the bases used to apportion indirect costs,

(4) appropriateness of the indirect cost period,

(5) consistency of the application of policies and procedures to the Government and to other operations, and

(6) mathematical accuracy of the computed final indirect cost rates.

#### **13-602.2 Certification of Indirect (F&A) Cost \*\***

a. 2 CFR 200, [Appendix IV](#), Section D addresses requirements for certification of indirect cost proposals.

b. All proposals submitted to negotiate indirect (F&A) cost rates must be certified by the nonprofit organization using the Certificate of Indirect (F&A) Costs set forth in Appendix IV. The certificate must be signed on behalf of the organization by an individual at a level no lower than vice president or chief financial officer for the organization.

c. Each indirect cost rate proposal must be accompanied by the certificate required in Appendix IV.



### **13-602.3 Indirect Cost Allocation – Overview \*\***

a. The Uniform Guidance at 2 CFR 200.414, and Appendix IV provides the guidelines for identifying and assigning indirect cost for the negotiation of indirect cost rates for nonprofit organizations.

b. Due to the diversity of nonprofit organizations' characteristics and accounting practices, [2 CFR 200.414](#) does not specify the types of cost which may be classified as indirect cost for nonprofit organizations in all situations. Identification with the Federal award, rather than the nature of the goods and services involved is the determining factor in distinguishing direct from indirect cost. §200.414 identifies the types of cost that must be classified as facilities or administration as follows:

(1) Facilities cost groupings include depreciation expense, interest expense, and operations and maintenance expense.

(2) Administration costs include those that are for the general administration and general expenses of the organization, such as expenses for the director's office, accounting department, and business services. If the nonprofit organization has a library, library expenses are classified as an administration cost, not a facilities cost.

c. The four potential methodologies that a nonprofit organization may use to develop its indirect cost rates are provided in 2 CFR 200, Appendix IV, Section B, which identifies specific methods for allocating indirect costs and computing indirect cost rates, along with the conditions under which each method should be used. These four methods are discussed below.

d. The base period for the allocation of indirect costs is the period in which the costs were incurred and accumulated for allocation to the work performed during that period. The base period must be selected in a manner that avoids inequities in the allocation of cost, and normally coincides with the organization's fiscal year (2 CFR 200, Appendix IV, Section B.1.e).

e. The auditor should determine if the allocation bases result in equitable distribution of cost, since the selection of the allocation bases may substantially affect allocation of indirect costs to Federal awards. If the organization uses an allocation method other than the default or prescribed method, the auditor should determine if the alternate method provides a more equitable distribution of cost.

### **13-602.4 Indirect Cost Allocation Methods \*\***

2 CFR 200, Appendix IV, Sections B.2 through B.4, provide guidelines for nonprofit organizations to identify and assign indirect costs for the negotiation of indirect cost rates. The four methods and conditions when each would be appropriate are discussed below.

#### **13-602.4.1 Simplified Allocation Method (Appendix IV, Section B.2) \*\***

a. The simplified allocation method can be used when the organization expends \$10 million or less in direct Federal funds. This method results in a single F&A rate that is applied to all final cost objectives and can be used when the following conditions exist:

(1) All major functions benefit from its indirect costs to approximately the same degree,

(2) There is only one major function that encompasses a number of individual projects or activities,

(3) The level of Federal awards to the organization is relatively small.

b. This allocation method is accomplished as follows:

(1) Total costs for the base period are identified and separated as either direct or indirect cost,

(2) Capital expenditures are excluded from both direct and indirect costs,

(3) Unallowable costs and credits are removed from the indirect cost grouping,

(4) Unallowable costs that represent activities described in [2 CFR 200.413\(e\)](#) must be included in the direct cost base.

(5) Dividing the total allowable indirect costs (net of applicable credits) by an equitable distribution base.

#### **13-602.4.2 Multiple Allocation Base Method (Appendix IV, Section B.3) [\\*\\*](#)**

a. This method must be used by organizations that expend more than \$10 million in direct Federal funds in a year. When major functions benefit in varying degrees from the indirect costs, allocation of indirect cost may require accumulating the costs in separate cost groupings which are then allocated individually to benefiting functions based on the benefit received.

b. Except where a special indirect cost rate is required, separate groupings of indirect costs must be aggregated and treated as a common pool for each function. Indirect cost pools must be classified within the two broad categories of “Facilities” and “Administration.” Each cost grouping is allocated to the benefiting functions, and other indirect cost pools, by means of a base that best measures the relative benefits. When expenses are not directly allocable, the allocation must be made through the use of a selected base that produces results equitable to both the Federal government and the nonprofit organization.

c. Actual conditions must be taken into account in selecting the bases. The essential consideration is that it is the one best suited for assigning the pool of costs to cost objectives in accordance with the benefits derived, a traceable cause and effect, or logic and reason if neither cause nor effect is determinable.

d. Unless the entity can demonstrate a more equitable allocation results from a different method, indirect costs must be allocated to other indirect cost groupings (cross allocation) as well as to major functions in the manner and order prescribed in Appendix IV, Section B.3.c. Cost categories not identified below should be allocated in the order determined to be most appropriate by the organization. The required order of allocation is:

(1) Depreciation must be allocated in the following order and manner:

(a). Depreciation on buildings used for a single function, and on capital improvements and equipment used in such buildings, must be assigned to that function.

(b) Depreciation on buildings used for more than one function, and on capital improvements and equipment used in such buildings, must be allocated to the individual functions performed in each building on the basis of usable square feet of space.

(c) Depreciation on buildings, capital improvements and equipment-related space used jointly by more than one function must be allocated to the benefiting functions on the basis of space usage. This can be calculated in one of two ways: 1) using a full-time equivalent



(FTE) basis or salaries and wages of employees and other users of individual functions benefiting from the assets, or 2) organization-wide employee FTEs or salaries and wages applicable to the benefiting functions.

(d) Depreciation on certain capital improvements to land (e.g., parking areas, fences, sidewalks, etc.) that are not included in the cost of buildings, must be allocated to user categories on an FTE basis and distributed to major functions in proportion to the salaries and wages of all employees applicable to the functions.

(2) Interest costs must be allocated in the same manner as depreciation on the buildings to which the interest relates.

(3) Operation and maintenance expenses must be allocated in the same manner as the depreciation.

(4) General administration and general expenses must be allocated to benefiting functions based on modified total costs (MTC). The MTC is the modified total direct costs (MTDC, plus the indirect costs allocated to the functions benefiting from the services).

e. An individual rate will be negotiated or determined for each indirect cost pool as well as the overall F&A indirect cost rate for each major function.

#### **13-602.4.3 Direct Allocation Method (Appendix IV, Section B.4) \*\***

a. Under this method, indirect costs consist exclusively of general administration and general expenses, that is, all costs are treated as direct costs except for general administration and general expenses. In all other respects, the indirect cost rates are computed in the same manner as that described for the Simplified allocation method discussed above in 602.4.1.

b. Costs are generally separated into three basic categories:

(1) General administration and general expenses,

(2) Fundraising, and

(3) Other direct functions, which includes projects performed under Federal awards.

c. Joint costs, such as depreciation, rental costs, operation and maintenance, telephone expense, etc., are prorated individually as direct cost to each of the above three categories and to each Federal award or other activity using a base appropriate to the particular cost being allocated.

d. The Direct Allocation Method is acceptable only if:

(1) Joint costs can be prorated using a base which accurately measures the benefits provided,

(2) Bases can be established in accordance with reasonable criteria, and are supported by current data.

#### **13-602.4.4 Special Indirect Cost Rates (Appendix IV, Section B.5) \*\***

In some instances, a single indirect cost rate for all activities of an organization or for each major function may not be appropriate since it would not take into account factors that may substantially affect the indirect costs applicable to a particular segment of work. For example, a

particular segment that only performs on a single Federal award. When a particular segment appears to generate a significantly different level of indirect costs, and the volume of work is material, provisions should be made for a separate indirect cost pool applicable to that work if it is determined that the separate rate differs significantly from the rate derived without the special rate.

### **13-603 Selected Areas of Cost – Nonprofit Specific \*\***

#### **13-603.1 Introduction \*\***

This section addresses cost principles that provide allowability criteria specific to nonprofit organizations that are not IHEs or government entities. [Section 507](#) provides general guidance for selected areas of cost that are applicable to all types of entities covered by 2 CFR 200, Subpart E.

#### **13-603.2 Compensation for Personal Services \*\***

a. Compensation must be reasonable for the actual personal services rendered, rather than a distribution of earnings in excess of costs, for certain individuals and their immediate family. This may include director and executive committee members' fees, incentive awards, allowances for off-site pay, incentive pay, location allowances, hardship pay, and cost-of-living differentials.

b. The auditor should determine if the compensation paid to the following individuals, and their immediate family members, is reasonable for the services performed:

- members of nonprofit organizations
- trustees
- directors
- associates
- officers

#### **13-603.3 Interest \*\***

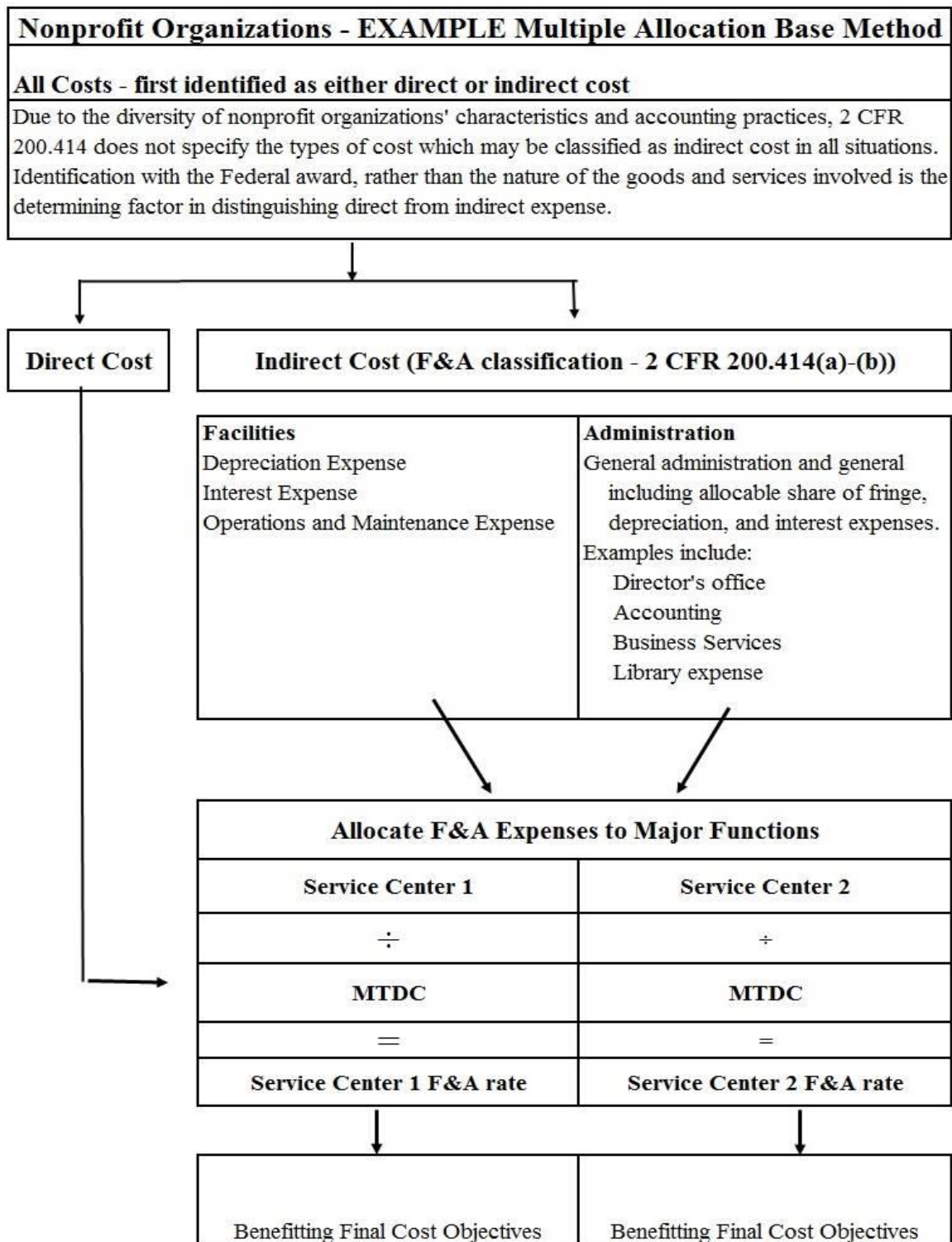
a. In addition to the criteria discussed in [section 507.4](#), the auditor needs to consider the additional criteria specific to nonprofit organizations in [§200.449\(f\)](#), which requires that, for organizations not subject to full-CAS coverage, the costs must be incurred in connection with acquisitions of capital assets that occurred after September 29, 1995 and were not acquired with the organization's funds (self-financing).

b. The provisions of §200.449 are not applicable to nonprofit organizations subject to full-CAS coverage, in which case, the Federal awards are subject to CAS 414 and CAS 417 will apply (§200.449(g)).

#### **13-603.4 Contributions and Donations of Services \*\***

The value of services donated to nonprofit organizations utilized in performance of a direct cost activity must be included in the indirect cost pool allocation base when the aggregate value of the services is material, and the services are supported by a significant amount of the indirect costs incurred.

Figure 13-6-1 Illustration – Multiple Allocation Base \*\*



## **13-700 Audits at Educational Institutions \*\***

### **13-701 Introduction \*\***

a. This section provides additional information for audits at educational institutions, and should be considered in conjunction with the general concepts presented in sections 100 through 500. identifies an Institution of Higher Education (IHE) as an organization that meets the definition at the [Title 20 of the United States Code §1001](#).

b. Audits at IHEs should be comprehensive for the scope required for the total group of auditable Federal awards. Audits of educational institutions can be complex due to the diversity in services procured and Federal program requirements, as well as the variety of types of Federal awards, which can include grants, cooperative agreements, and negotiated contracts. (See [section 500](#) and Chapter 4 for general audit guidance, which is applicable to all types of audits, including audits of educational institutions).

### **13-702 Audit Objectives \*\***

The audit objectives in the DCAA audit of an IHE is to determine if costs included in claims, proposals, and financial reports under Federal awards are reasonable, fairly presented, appropriately charged or allocated, and determined in accordance with the terms and conditions of the awards and applicable regulations.

### **13-703 Educational Institution Accounting Systems \*\***

Essentially, an IHE accounting system should be similar to accounting systems of nonprofits and for-profit organizations that the auditor has encountered. Although the IHE may have a complex and diversified system depending on the size of the institution, types of programs, and the location of campuses, this is really no different than the accounting systems of large and geographically dispersed defense contractors, except that the IHE's accounting system may not be subject to DFARS 242.75 criteria. While there are no special requirements for an IHE's accounting than there are for other types of contractors, the IHE must design and maintain its accounting system to ensure it enables compliance with Federal regulations and provides reasonable assurance of meeting the program objectives. See also [section 504\(c\)](#). Auditors performing accounting system audits should consult with their Regional Technical Programs (RST) divisions or Headquarters Policy & Plans, as needed, for assistance in determining criteria.

### **13-704 Cost Accounting Standards (CAS) - Universities \*\***

a. The Cost Accounting Standards Board's (CASB) rules and regulations applicable to IHEs are implemented through 48 CFR 9903 and 9905 ([48 CFR 9903.201-2\(c\)](#)).

b. DCAA will not self-initiate CAS compliance or disclosure statement audits at IHEs. When the cognizant Federal agency for indirect costs requests DCAA to perform a CAS audit, the auditor will need to build upon the independent public accountant's (IPA) audit procedures performed for the single audit, as well as any work performed by DCAA during the Uniform Guidance Compliance audit, in order to avoid duplicative audit work. To gain access to the IPA's working papers, the auditor should ask the cognizant agency to request the IPA's working papers so that the auditor can determine if the procedures and work performed are sufficient for the needs of the audit. The auditor should follow the guidance in [4-1000 through 4-1006](#).

### **13-704.1 Applicability \*\***

a. An IHE can become subject to CAS if any of the following criteria are met:

(1) In accordance with [2 CFR 200.419](#), an IHE that receives aggregate Federal awards that are subject to 2 CFR 200 (e.g., grants, cooperative agreements, loans) and CAS-covered cost-reimbursement contracts subject to FAR, totaling \$50 million or more in its most recently completed fiscal year must comply with the cost accounting standards (CAS) at 48 CFR 9905. Grants and Cooperative agreements are not subject to the provisions of FAR Part 30. CAS-covered FAR-based contracts are administered under FAR Part 30.

(2) When an IHE receives a negotiated contract in excess of the Truth in Negotiations (TIN) threshold, the institution is subject to the CAS requirements at 48 CFR 9900 through 9999 and FAR Part 30.

(3) If the IHE operates an FFRDC, the FFRDC is subject to the cost accounting standards at 48 CFR 9904 and the FFRDC contracts are excluded from the institution's universe of contracts when determining CAS applicability and disclosure statement requirements for contracts performed by other than the FFRDC (48 CFR 9903.201-2(c)(3) and (4)).

b. When existing contracts are subject to CAS coverage, the contracting officer may continue to apply CAS coverage defined at 9903.201-2(a) for continuity of coverage (§9903.201-2(c)(6)).

### **13-704.2 Cost Accounting Standards 2 CFR 200.419 \*\***

a. Negotiated contracts and subcontracts: When an institution receives a negotiated contract or subcontract in excess of the TIN threshold, the contract will include the contract clause at [48 CFR 9903.201-4\(e\)](#) requiring the institution to comply with the cost accounting standards identified in [48 CFR 9905](#) and the provisions of 48 CFR 9900 through 9999 and FAR Part 30. Institutions are required to submit a disclosure statement as prescribed in [48 CFR 9903.202-1](#). The CAS rules also identify specific requirements for IHEs to submit a disclosure statement in 9903.202-1(f).

b. Financial Assistance (2 CFR 200.419 CAS requirements). IHEs that received aggregate Federal awards, which includes FAR-based negotiated contracts, totaling \$50 million or more subject to 2 CFR 200 during the most recently completed fiscal year are subject to the CAS at 48 CFR 9905.

c. The CAS applicable to IHEs are contained in [48 CFR 9905](#) and are the equivalent of modified CAS for nonprofit and for-profit organizations. The auditor should review each standard to ensure an understanding of the criteria. See also [Chapter 8](#) for general guidance in conducting audits to test for compliance with CAS. The following four CAS are applicable to IHEs and provide links to various subparts of each standard:

(1) CAS 501 – Consistency in estimating, accumulating and reporting costs.

i. [9905.501-20](#) provides the purpose of this Standard.

ii. [9905.501-40](#) provides fundamental requirements.

iii. [9905.501-50](#) provides techniques for application.

(2) CAS 502 – Consistency in allocating costs incurred for the same purpose.

- i. [9905.502-20](#) provides the purpose of this Standard.
- ii. [9905.502-40](#) provides fundamental requirements
- iii. [9905.502-50](#) provides techniques for application.
- iv. [9905.502-61](#) provides interpretations relating to treatment of costs incurred in preparing, submitting, and supporting proposals.

(3) CAS 505 – Accounting for unallowable costs.

- i. [9905.505-20](#) provides the purpose of this Standard.
- ii. [9905.505-40](#) provides fundamental requirements.
- iii. [9905.505-50](#) provides techniques for application.

(4) CAS 506 – Cost accounting period.

- i. [9905.506-20](#) provides the purpose of this Standard.
- ii. [9905.506-40](#) provides fundamental requirements.
- iii. [9905.506-50](#) provides techniques for application.

d. CASB rules and regulations for administration of CAS for educational institution are contained in 48 CFR [9903.201-7](#), and [9903.202-6](#).

### **13-704.3 Disclosed Practices (DS-2) \*\***

a. IHEs that received \$50 million in aggregate Federal awards, which includes FAR-based negotiated contracts, during the most recently completed fiscal year must comply with 48 CFR 9905 pursuant to 2 CFR 200.419. Disclosure statement requirements and filing thresholds applicable to IHEs receiving FAR-based contracts and subcontracts are discussed in 48 CFR 9903.202-1(f).

b. If the IHE has been awarded CAS covered FAR-based contracts and subcontracts then it may be subject to CAS under 48 CFR 99, as those contracts are administered under FAR Part 30, Cost Accounting Standards Administration. Changes in cost accounting practices that impact these contracts must be submitted 60 days prior to implementing the change.

c. As part of the planning and performance of audits (other than a requested Disclosure Statement audit), the auditor should obtain and review the DS-2 (if required) to determine if the actual practices are consistent with disclosed practices. The auditor should evaluate the significance of any noncompliance, communicate with the cognizant agency for indirect rates, and report material noncompliances with CAS following the guidance in other sections of CAM, including 6-708.1(e), 6-709.2, 8-302.7, 10-208.7(e), and 14-120.2.

### **13-704.4 CAS Administration \*\***

a. CAS administration requirements are contained in [48 CFR 9903.201-7](#) and [9903.202-6](#). To the maximum extent practicable, the cognizant Federal agency for indirect rates will take the lead role in administering the CAS requirements. To ensure equitable treatment of indirect costs, the CAS requirements should not be administered on a contract-by-contract basis. See Chapter 8 for discussion of CAS administration for FAR-based contracts.

b. FAR-based contracts are subject to the administrative requirements at FAR Part 30.



Financial assistance awards (e.g., grants, cooperative agreements, etc.) are administered under 2 CFR 200.419.

c. DCAA performs audits of disclosure statements only upon request from the cognizant agency for indirect rates. The auditor should design the audit to build upon the audit effort performed during the annual single audit in order to avoid duplication of audit effort. The auditor should coordinate with the requestor to obtain information and working papers from the IPA, or coordinate with the DCAA cognizant office that participated in the single audit, to determine if any applicable audit effort was performed on which reliance can be placed.

#### **13-704.5 CAS Noncompliance \*\***

a. Excess amounts paid due to a noncompliance must be credited or refunded along with applicable interest on the excess amounts paid during the period of the noncompliance.

b. Changes from one compliant practice to another compliant practice that are approved by the cognizant agency for indirect costs may require cost adjustments.

c. CAS noncompliances affecting FAR-based cost-reimbursement contracts are resolved through the FAR Part 30 requirements.

#### **13-705 Audit Planning - Observation of Performance Areas \*\***

Auditors should gain an understanding of space utilization to assist in determining the reliability of the proposed costs allocated to organized research and instructional activities. Audit procedures should be developed to determine the reasonableness of the allocation of operation and maintenance costs. If the IHE has prepared a schedule of space utilization, the auditor should obtain that schedule to evaluate the reasonableness of the IHE's assertions during the physical inspection of the research facilities.

##### **13-705.1 Research Facilities \*\***

a. The auditor should perform perambulations at major areas of research performance. A technical representative of the IHE and the Government technical office should accompany the auditor.

b. The visit should occur when activities representing normal use of the facility are in process. For example, the visit should not take place during summer vacation or other academic break periods.

c. During the visit, the auditor should gain an understanding of the types of research performed and the schools involved in order to establish an understanding of the percentages of space and utilization between instructional activities (including departmental research) and organized research activities. Space utilization applicable to other institutional activities is usually readily determinable.

##### **13-705.2 Non-research Facilities \*\***

The auditor should make physical observations of institutional locations where a significant amount of work under non-research agreements is being performed. To determine appropriate allocation of costs, the auditor needs to understand the on-campus costs that do not apply to Federal awards performed at off-campus locations. Additionally, performance of some on, or near, campus laboratories or research areas may not be applicable to other Federal projects due to their autonomy, that is, the research activities are not supervised by the IHE's deans or

instructional department heads, and the facilities maintain their own administrative, purchasing, personnel, and accounting staffs.

### **13-705.3 Off-Campus Locations \*\***

The auditor should determine if the IHE performs on Federal awards at off-campus locations by reviewing the list of facility locations or making physical visits to the facilities. If the IHE has off-campus facilities, the auditor should perform the following:

(1) Determine if the costs incurred at the off-campus locations benefit from costs incurred at the on-campus facilities. For example, some off-campus locations operate autonomously and have their own library, accounting, billing, and departmental functions. The auditor should verify that costs incurred at the on-campus location are only allocated to the off-campus facility when the off-campus facility benefits from the on-campus activities. Additionally, the auditor should verify that the costs incurred solely for the benefit of the off-campus facility are allocated only to Federal awards performed at that location. If the IHE does not have an off-campus indirect rate, which would eliminate on-campus costs that are not appropriately allocable to the off-campus location, the auditor should recommend off-campus rates be developed to ensure equitable allocation of cost.

(2) If the IHE has off-campus indirect rates, the auditor should perform audit procedures to determine if the cost is appropriately allocated to the benefiting locations.

### **13-706 General Audit Procedures \*\***

a. DCAA audits at IHEs should be comprehensive for the scope required for the total group of auditable Federal awards. Auditors should consider materiality in determining the scope of audit. Audits of IHEs can be complex due to the diversity in services procured and Federal program requirements, as well as the variety of types of Federal awards, which can include grants, cooperative agreements, and contracts. (See [section 500](#) and CAM Chapter 4 for general audit guidance, which is applicable to all types of audits, including audits of IHEs).

b. The auditor should gain an understanding of the terms and conditions in Federal awards. Agreements may differ, for example, some awards may require the awarding agency give prior approval for designated types of expenditures, or there may be limitations on cost or specific types of transactions. This effort should include determining the adequacy of the IHE's procedures and internal control to ensure compliance with special provisions included in the terms and conditions of Federal awards.

c. Audit procedures should enable the auditor to evaluate the reliability of centralized administrative and financial internal controls, including the accounting system, and provide sufficient evidence, from testing selected transactions, of allowability and allocability of cost and compliance with terms and conditions of Federal awards and applicable regulations.

d. The discovery of fraud or other unlawful/improper activity is not the primary audit objective, but the auditor must be attentive to any condition that suggests such a situation may exist, which should be reported in accordance with [4-700](#).

### **13-707 Audit of Direct Costs \*\***

a. The auditor should gain an understanding of the terms and conditions of the Federal awards, and the IHE's internal controls and design procedures to determine if costs charged direct are allowable in accordance with the cost principles, and allocated to the appropriate



institutional functions. See [CAM Chapter 6](#) for audit guidance for auditing various types of cost.

b. In some circumstances, costs typically treated as an indirect cost may be charged as direct cost when an individual Federal award benefits specifically from the cost and the allocation of the cost results in equitable charging to Federal awards. An IHE may, for example, identify fringe benefit or pension costs directly with specific Federal awards. Auditors should perform procedures to determine if the IHE consistently applies the same methodology for similar costs in like circumstances ([CAS 502](#) when applicable). Auditors should also determine if any special distribution methods result in recovery of more cost than actually incurred and that any limitations on indirect costs are not circumvented.

### **13-708 Audit of Indirect Costs \*\***

This section provides guidance for IHEs that develop both the administration and facilities portions of the indirect cost rate.

#### **13-708.1 Introduction \*\***

a. The Uniform Guidance at 2 CFR 200, Appendix III, Section A identifies the major functions of the IHE (see [Figure 13-7-1](#) for an illustration), and prescribes the criteria for assigning indirect costs to specific cost groupings within the facilities and administration cost categories for distribution to major functions and subsequently to Federal awards.

b. Appendix III, Sections B.2 through B.4 provide guidelines for IHEs to identify and assign indirect costs for the development and negotiation of indirect cost (F&A) rates.

c. Appendix III, Section C contains the guidelines for indirect cost rate development using the regular (Standard Format) method. Large IHEs that expend more than \$10 million in direct Federal funds for a fiscal year are required to use the regular method described in Appendix III, Sections A through C.

d. IHEs that expend \$10 million or less in direct Federal funds for a fiscal year may use a simplified method for development of F&A cost rates (Appendix III, Section D). The simplified method is discussed in [section 712.2](#).

e. Appendix III, Sections E and F, apply to both large and small IHEs.

#### **13-708.2 Audit Objective \*\***

CAM [6-600](#) provides general guidance in establishing the scope of audit and performing audits of indirect costs. The audit objectives are to evaluate and determine:

- allowability, allocability, and reasonableness of the costs charged to Federal awards,
- propriety of the methods used to allocate indirect costs to Federal awards,
- appropriateness of the bases used to apportion indirect costs,
- appropriateness of the indirect cost period,
- consistency of the application of policies and procedures to the Government and to other operations, and
- mathematical accuracy of the computed final indirect cost rates.

### **13-708.3 Certification of Indirect Cost (F&A) Proposals \*\***

Indirect cost rate (F&A) proposals must include certain certifications. 2 CFR 200, Appendix III, F.1 requires a certification of charges be submitted with all indirect cost proposals. The certification of indirect costs must be signed by the chief financial officer (CFO) or individual at a level no lower than vice president or CFO.

### **13-708.4 Audit Planning – Reconciliations and Account Analysis \*\***

a. 2 CFR 200 Appendix III requires costs be assigned to specific cost groupings and allocated over specified bases. This generally requires reclassification of cost per the general ledger to the cost groupings. The IHE should reconcile the costs in the proposal, both allocation bases and indirect cost groupings, to the IHE's audited financial statements.

b. The auditor should verify that all incurred costs, whether allowable or unallowable, income, and credits relevant to the Federal awards are appropriately reflected in the IHE's indirect cost rate proposal.

c. The auditor should perform an analysis of the individual accounts sufficient to identify the risk areas and determine the nature, timing and extent of audit procedures to be performed. See 6-608 and the [Variable Sampling guidebook](#) for guidance in developing and evaluating transaction testing plans. Additionally, 6-608.2 provides audit techniques to evaluate and select accounts for testing.

### **13-708.5 Facilities and Administration Cost Groupings \*\***

Appendix III to Part 200 prescribes the requirements for development and submission of F&A cost rate proposals and cost allocation plans.

#### **13-708.5.1 Facilities Indirect Cost Groupings and Classifications \*\***

a. After identifying and distributing direct costs, the indirect costs must be assigned to cost groupings, or pools, for allocation to major activities and functions. "Facilities" and "Administration" are the two overarching indirect cost categories ([2 CFR 200.414](#)). Within these two broad categories, subcategories of certain types of cost must be classified to specific cost groupings. A cost grouping is a pool of expenses that are of like nature in terms of the relative contribution to the allocation base (2 CFR 200, [Appendix III](#), Section A.2.b)). (See [section 712.2](#) for indirect cost groupings using the simplified method.) 2 CFR 200, Appendix III, Section B identifies specific cost subcategories within the Facilities and Administration categories. See [Figure 13-7-1](#) for an illustration.

b. Auditors should determine if costs are assigned to the appropriate cost groupings, in accordance with the requirements of the Uniform Guidance, and have similar causal or beneficial relationships with the allocation base. The rate structure must also ensure that Federal funds not subsidize industry or foreign government programs, and the auditor should determine if allocation bases contain all benefiting awards.

c. The Uniform Guidance at 2 CFR 200.414 defines the cost categories for Facilities and Administration costs and Appendix III prescribes the requirements for development and submission F&A cost rate proposals and cost allocation plans. Appendix III.A.1.a specifically identifies "instruction" as a major function of an IHE distinct from organized research activities. Appendix III.A.1.a(1) identifies instructional activities associated with sponsored instruction and training. Auditors should consider instructional costs as unallowable to research agreements,

unless they meet the criteria of Appendix III.A.1.a(1), which requires that specific instructional or training is provided for in the terms and conditions of the award.

#### **13-708.5.2 Depreciation \*\***

a. In addition to the allowability criteria related to depreciation discussed in [section 507.3](#), the auditor needs to consider the allocation requirements contained in 2 CFR 200, Appendix III, Section B.2.

b. Under OMB Circular A-21, IHEs were permitted to apply a “use allowance” rather than use depreciation to recover costs to acquire assets. For assets that were in place prior to implementation of 2 CFR 200, IHEs may continue to use the “use allowance” for those assets. For assets acquired after December 26, 2014, IHEs must use depreciation to recover costs for the asset. Additionally, IHEs will continue to negotiate rates that were based on use allowance until the rate is renegotiated.

c. Where assets are used for operations and maintenance (O&M) activities, the O&M expense pool should receive an equitable distribution of the related depreciation expense. Once allocated to the O&M expense pool, the depreciation costs become part of the overall O&M expense pool and will be treated, for allocation purposes, as part of the O&M pool. Though categorized as an O&M expense at this point, the depreciation expense should be identifiable as depreciation expense to permit reconciliation to the financial statements.

#### **13-708.5.3 Interest \*\***

a. In addition to the allowability criteria related to interest discussed in [section 507.4](#), the auditor needs to consider the allocation requirements contained in 2 CFR 200, Appendix III, Section B.3.

b. According to §200.449(e), for costs to be allowable for an IHE, the interest costs must have been incurred after September 23, 1982, in connection with acquisitions that occurred after that date.

c. Interest on debt associated with buildings, equipment and capital improvements defined in [§200.449](#) must be classified as an expenditure under the Facilities category. These costs must be allocated in the same manner as the depreciation on the buildings, equipment and capital improvements to which the interest relates (Appendix III, Section B.3).

d. Where assets are used for operations and maintenance (O&M) activities, the O&M expense pool should receive an equitable distribution of the related interest expense. Once allocated to the O&M expense pool, the interest costs become part of the overall O&M expense pool and will be treated, for allocation purposes, as part of the O&M pool. Though categorized as an O&M expense at this point, the interest expense should be identifiable as interest expense to permit reconciliation to the financial statements.

#### **13-708.5.4 Operation and Maintenance \*\***

a. Operation and maintenance (O&M) costs are defined in 2 CFR 200 Appendix III, Section B.4, and include an allocation of depreciation and interest and from other expense pools or through cross-allocations. Aggregated expenses including Depreciation and Interest allocated to the O&M cost grouping will be allocated in the same manner as O&M costs, but should be separately identified to allow reconciliation to financial statements.

b. In the absence of alternatives provided for in 2 CFR 200, Appendix III, Section A.2.d, these expenses must be allocated in a specified order: first to buildings used exclusively to conduct a single function, then to buildings used for more than one function, then to buildings related to space (e.g., individual rooms, laboratories) used jointly by more than one function. Allocations to the O&M pool from other expense pools, or through cross-allocations, are aggregated with the O&M expenses for allocation purposes.

c. The auditor should determine if the costs, including any allocated costs from other expense pools, such as depreciation and interest, are allowable, reasonable, and allocated in the order required by Appendix III.B.4.b. For O&M costs assigned to buildings separately, the auditor should evaluate the basis of the distribution to all applicable cost objectives, such as obtaining work orders for repair and maintenance activities. Where work orders are not used, the auditor should evaluate the basis for space utilization to determine if the allocation of O&M cost is equitable.

d. Utility Cost Adjustment

(1) For organized research, IHEs may include a utility cost adjustment of up to 1.3 percent in the negotiated indirect cost rate in accordance with the prescribed computation alternatives identified in Appendix III, Section B.4.c:

i. Where space is devoted to a single function and metering allows unambiguous measurement of usage, the measured cost must be assigned to the function located in that space.

ii. Where space is allocated to different functions and metering does not allow unambiguous measurement of usage by function, costs must be apportioned by calculating the difference between the actual square footage and the effective square footage of a site or building. Effective square footage is calculated as the actual square footage times the relative energy utilization index (REUI) posted on the OMB Web site at the time of the rate determination. If no current rate is posted on the OMB website, the default adjustment ratio value is 2.

e. The auditor should verify that utility costs allocated to organized research were calculated using the appropriate REUI. If utility costs are further allocated to service centers or other functions that the Government participates in, the auditor should perform procedures to determine if the reallocated utility costs are double counted or recovered more than once.

f. If the IHE uses weighting factors, these should be supported by a well-documented comprehensive study. The auditor should evaluate the justification for weighting factors and determine if the results are equitable. If necessary, the auditor should request assistance from a Government technical specialist (See the [Appendix B](#)).

**13-708.6 Administration Indirect Cost Groupings and Classifications \*\***

Administration costs are defined as general administration and general expenses and include indirect costs such as the director's office, accounting personnel and all other types of expenditures not listed specifically under one of the subcategories of "facilities".

**13-708.6.1 Alternative (Allowance Method) for Administrative Costs \*\***

a. For negotiation of indirect cost (F&A) rates, Appendix III, Section C.9 permits an IHE to elect to use an allowance of 24 percent of modified total direct cost or 95 percent of the

most recently negotiated fixed or predetermined rate for cost pools included in the “administration” cost category, whichever is less, in lieu of allocating actual administration indirect costs. If this option is elected, the IHE does not need to develop the “administration” portion of the F&A cost rate, and no further documentation is required to support the costs.

b. If the IHE uses this alternative, the auditor should verify that the IHE excluded the following costs from indirect cost pools and no additional testing of the administration expenses is required:

- (1) General administration expenses (Appendix III, Section B.5)
- (2) Departmental administration expenses (Appendix III, Section B.6)
- (3) Sponsored projects administration (Appendix III, Section B. 7), and
- (4) Student administration services (Appendix III, Section B.9)

#### **13-708.6.2 General Administration and General Expenses \*\***

a. General administration and general expenses are those that have been incurred for the general executive and administrative offices of the IHE, and other expenses of a general character that do not relate solely to any major function of the IHE. Costs in this category should also contain their allocable share of fringe benefit costs, depreciation, interest, and operation and maintenance expense.

b. Expenses incurred within non-university-wide deans’ offices, academic departments, organized research units, or similar organization units must be excluded from the general administration and general expenses cost grouping.

c. The costs must first be grouped according to common major functions to which they provide services or benefits. The aggregate expenses of each group will then be allocated to the serviced or benefiting functions based on modified total cost, which consists of the same elements as the MTDC (2 CFR 200, Appendix III, Section B.5.b). The IHE may use an alternative method of distribution only if it can demonstrate the alternative method results in a more equitable allocation of cost, or that a more readily available base would not increase cost charged to Federal awards.

d. Costs incurred for the following general administrative activities must be limited to 26 percent of the modified total direct cost for each function. The limitation applies to the total of: departmental administration, sponsored projects administration, student administration and services (including their allocable share of depreciation, interest, O&M, and fringe benefits), and all other types of expenditures not listed specifically under any of the other facilities categories. The auditor should verify that the IHE appropriately applied the cost limitation for the F&A rate developed for each major function (2 CFR 200, Appendix III, Section C.8.a). [DFARS 231.303](#) prohibits the application of the 26 percent limitation to DoD contracts unless the IHE requests a waiver of the restriction in order to simplify management of contracts. The auditor should verify the existence of the waiver when applicable.

#### **13-708.6.3 Library Expenses \*\***

a. Library expenses are addressed in 2 CFR 200, Appendix III, Section B.8 and include costs incurred for the operation of the library, including the cost of books and library materials purchased for the library, less any library income that qualifies as a credit ([2 CFR](#)

[200.406](#)). Library expense category should include fringe benefits applicable to the salaries and wages (including tuition remission) of library employees and an appropriate share of general administration and general expense, O&M, and depreciation.

b. Rare books (museum-type books) with no value to Federal awards should not be allocated to Federal awards.

c. In the absence of alternative allocation methods provided for in 2 CFR 200, Appendix III, Section A.2.d, the expenses must be allocated in the manner specified in Appendix III, Section B.8.b. This methodology requires the expenses be allocated first on the basis of primary categories of users. The user categories must be:

(1) Students. This category consists of full-time equivalent students enrolled at the IHE, regardless of whether they earn credits toward a degree or certificate.

(2) Professional employees. This category consists of all faculty members and other professional employees of the IHE on a full-time equivalent basis. Graduate students and post-doctorate fellows may be included in this category rather than the student category.

(3) Other users. This category consists of a reasonable factor, as determined by the IHE's records (such as logs of accesses granted) to account for all other users of the library facilities.

d. After determining the user base by the categories defined above, the expenses must be assigned in the manner prescribed in Appendix III, Section B.2.c:

(1) The amount apportioned to the student category must be allocated to the instruction function of the IHE.

(2) The amount apportioned to the professional employee category must be assigned to the major functions of the IHE in proportion to the salaries and wages of all faculty members and professional employees applicable to those functions.

(3) The amount apportioned to the other users category must be assigned to the other institutional activities function of the IHE.

e. The auditor should perform procedures necessary to determine if the IHE appropriately identified the individuals in the three categories, properly calculated the full-time equivalent factors, properly assigned the expense to each category, and appropriately allocated the costs from the categories to the major functions as required.

f. If material, the auditor should perform procedures necessary to evaluate the reasonableness of costs of books, periodicals, and materials.

#### **13-708.6.4 Departmental Administration Expenses [\\*\\*](#)**

a. These types of expenses are addressed in 2 CFR 200, Appendix III, Section B.6 and include costs incurred for administrative and supporting services that benefit common or joint departmental activities or objectives in academic deans' offices, academic departments and divisions, and organized research units, such as institutes, study centers, and research centers.

b. Academic deans' offices: salaries and operating expenses are limited to those attributable to administrative functions.

c. Academic departmental personnel exclude professional business or professional



administrative officers. Salaries and fringe benefits attributable to the administrative work, including bid and proposal preparation, of faculty, including department heads, and other professional personnel conducting research and/or instruction are allowed at a rate of 3.6 percent of the modified total direct costs. This rate is added to the F&A cost rate for major function (Appendix III, B.6(2)(a)). No further documentation is required to support this allowance. The auditor should verify that the expenses covered by the 3.6 percent allowance are excluded from the departmental administration cost pool.

d. Items such as office supplies, postage, local telephone costs, and memberships must normally be treated as indirect cost.

e. The auditor should determine if other expenses incurred in the academic departments are allowable in accordance with the cost principles and terms and conditions of agreements, are appropriately categorized as direct or indirect cost, and are treated consistently as direct or indirect cost in like circumstances, including salaries of secretarial and clerical staff, salaries of administrative officers and assistants, travel, office supplies, etc. If audit procedures identify misclassified costs, the auditor should adjust the pools and bases accordingly.

f. The auditor should determine if the IHE allocated the expenses in accordance with the Uniform Guidance requirements. In the absence of alternatives for allocation provided in Appendix III, Section A.2.d, departmental administrative expenses must be allocated in the manner prescribed in Appendix III, Section B.2.c, which requires that expenses for each dean's office must be allocated to the academic department within their respective college or school on the modified total cost basis and then each academic department, along with its allocable share of indirect cost, must be allocated to the appropriate functions of the department on the modified total cost basis.

#### **13-708.6.5 Sponsored Projects Administration Expense \*\***

a. Sponsored projects administration expenses are limited to costs incurred by a separate organization established primarily to administer sponsored projects, including such functions as grant and contract administration, special security, purchasing, personnel, administration, editing and publishing research, etc.

b. The expenses include salaries and costs of activities of the head of the organization, assistants, and immediate staff along with the salaries and expenses of personnel engaged in supporting the activities performed by the organization (such as stock rooms and print shops, etc.).

c. The expenses should include their allocable share of fringe benefit costs, general administration and general expenses, operation and maintenance expenses, and depreciation.

d. When services are provided to other functions or organizations, the expenses should be appropriately adjusted so the cost of the service provided is allocated to the benefiting function or organization.

e. If the IHE does not account for these types of expenses separately, the auditor should consider the materiality of including the costs in other cost groupings (usually general administration and general expenses) before attempting to segregate the costs into a separate cost grouping.

f. If a sponsored project is administered independently (that is, has its own purchasing



or personnel department for example), the auditor should determine if that project received an inequitable allocation of cost through the sponsored projects administration expense cost grouping. The auditor should determine if the separately administered sponsored project should have a selective distribution of the indirect expenses rather than being included in the allocation base based on the project's direct cost.

#### **13-708.6.6 Fringe Benefit and Pension Costs \*\***

a. Auditors should perform procedures to determine if the fringe benefits are allowable in accordance with [2 CFR 200.431](#). Fringe benefits are generally allowable if the benefits are reasonable and are required by law, the IHE's established policy, or an employee-IHE employment agreement. Fringe benefits may be assigned to cost objectives by identifying specific benefits to specific individual employees, or through allocation on the basis of entity-wide salaries and wages of the employees receiving the benefits. Fringe benefits allocated to direct employees become part of the direct cost base for allocation of indirect (F&A) costs.

b. IHE contributions for expenses for social security, insurance (see [§200.447](#) for exceptions), pension costs, and other similar benefits are allowable if the benefits are granted under established written policies and are allocated to Federal awards and all other activities in a manner consistent with the pattern of benefits attributable to the individuals or groups of employees whose salaries and wages are chargeable to Federal awards and other activities, and that they are charged as direct or indirect cost in accordance with the IHE's accounting practices. The auditor should perform audit procedures to determine if:

(1) The IHE has a formal written policy that is adequate to ensure the IHE complies with the requirements of §200.447 and properly allocate the costs to Federal awards. If the IHE is self-insured, the auditor should verify that payments do not exceed the lower of actual expenditures or the cost of purchasing outside insurance.

(2) The IHE consistently treats fringe benefits as direct or indirect costs in like circumstances in accordance with its accounting practices.

(3) Fringe benefits are allocated through rates for separate groupings of employees, unless the IHE demonstrates that the relationship of fringe benefit costs to salaries and wages does not differ significantly between the groups of employees.

(4) The fringe benefit rate used to apportion the fringe benefits to the wages and salaries is appropriately calculated and that the rates reasonably allocate the costs proportionately with the applicable wages and salaries that benefit from the benefits.

(5) Fringe benefits assigned directly to Federal awards are appropriately identified with direct cost of the employees benefiting from the benefits.

(6) The direct cost allocation base for distribution of indirect (F&A) costs includes the applicable fringe benefits costs for the direct wages and salaries in the base.

c. Benefits for university employees may be provided through a state-wide fringe benefit program ([2 CFR 200.431\(k\)](#)). Because the state is paying the costs, the IHE may not record them in the IHE's accounting records. The IHE may charge the state-paid benefits to Federal awards if the costs meet the criteria identified [2 CFR 200.402 through §200.411](#) Basic Considerations, which requires, among other things, that the costs:

- Are reasonable and allocable,

- Are necessary for performance of the Federal award,
- Conform with any limitations or exclusions identified in the cost principles or the Federal award terms and conditions,
- Are consistent with institutional policies and procedures that apply uniformly to both Federally and non-Federally funded activities,
- Are treated consistently as a direct or indirect cost in similar circumstances,
- Are determined in accordance with GAAP,
- Are not included as a cost or used to meet cost sharing requirements of any Federal award in either the current or a prior period,
- Are adequately documented,
- Have received prior approval by an awarding agency, if required.

d. The state-paid fringe costs should not be questioned solely because the IHE has not recorded them in its accounting records. The auditor should verify documentation to substantiate the payment of the costs by the state and determine if the costs are appropriately included in the corresponding direct cost allocation or indirect cost pool for the employees that received the benefits.

### **13-709 Other Institutional Activities \*\***

“Other institutional activities” are all activities except for instruction, departmental research, organized research, and other sponsored activities (2 CFR 200, Appendix III, Section A.1). This section provides general guidance for other institutional activities commonly seen during DCAA audits.

#### **13-709.1 University Owned/Operated Hospitals \*\***

##### **13-709.1.1 Relationship of Hospitals to Institutional Activities \*\***

a. The medical schools of IHEs may operate hospitals as a public service to their communities, introducing complexities in indirect cost allocations. Although the hospital may be physically located on or near the campus, hospitals generally function autonomously (similar to off-campus facilities). The auditor should gain an understanding of the relationship between the hospital and the IHE and perform procedures to determine if cost allocations to and from the hospital are reasonable and result in equitable distribution of cost to benefiting activities.

b. The auditor should perform procedures to determine if reimbursement rates are equitable between the IHE and hospital. Cross-servicing activities, for example, the IHE providing utility and power facilities to the hospital, are commonly provided on a reimbursable basis to permit proper determination of patient care costs.

c. For general administration and general expenses generated by the hospital, the auditor should determine if hospital general administration and general expenses are allocated only to the hospital activities. These types of cost should be accounted for in the hospital’s accounting records. Examples of such functions are purchasing, accounts payable, patient billing, cost accounting, etc.

### **13-709.1.2 Institutional General Administrative and General Expenses Allocated to the Hospital \*\***

a. The overall objective of the indirect cost allocation process is to distribute the indirect costs in proportions consistent with the nature and extent of their use of the resources. This may require selective distribution of cost in some circumstances (Appendix III, Section A.2.b), such as when the hospital does not benefit from the institutional general administrative activities (e.g., it performs its own general administration activities). Audit procedures should be performed to determine if the allocation of institutional general administrative and general expenses results in a reasonable apportionment of the cost based on the benefits to the receiving functions.

b. IHEs must allocate general administrative and general expenses using a modified total direct cost (MTDC) base, or an acceptable alternative (2 CFR 200, Appendix III, Section B.5.b). The MTDC base is comprised of: all direct salaries and wages, applicable fringe benefits, materials and supplies, services, travel, and up to the first \$50,000 of each subaward and subcontract (2 CFR 200, Appendix III, Section C.2).

c. When the hospital is included in the MTDC allocation base for the IHE's general administration and general expenses, but performs many of its own general administrative activities, including the hospital's total direct costs in the allocation base may result in inequitable distribution of the cost.

d. Any institutional general administration and general expenses that are directly allocable to the hospital operations should be included as part of the hospital direct costs and removed from the general administration and general expenses pool.

### **13-709.2 Dining Halls \*\***

a. Dining halls (2 CFR 200, Appendix III, Section A.1.3) are evaluated for cost allowability under [§200.468](#) Specialized service facilities, and are allowable provided they meet certain conditions and take into account items of income or applicable credits.

b. The auditor should perform procedures to determine if the costs for dining hall services, when material, are charged directly to applicable awards based on actual usage, which may be through the use of a schedule of rates or established methodology as prescribed under §200.468(b) to ensure the IHE:

(1) Does not discriminate between activities under Federal awards and other activities, including usage by the IHE for internal purposes, and

(2) Recovers only the aggregate costs of the services, normally consisting of both the direct costs and the allocable share of all indirect costs.

(3) Adjusts rates at least biennially and accounts for variances to actual cost of previous periods.

c. When costs related to dining hall services are not material, they may be allocated as indirect (F&A) costs through the "other institutional activities" function.

### **13-709.3 Student Health Services \*\***

When health services are available to students and other IHE employees, auditors should determine if the cost of the operation of the activity is distributed to major functions on an

equitable basis.

#### **13-709.4 Institution Planning and Development \*\***

Costs related to general planning and development for the IHE are allocable to all institutional activities if the costs are otherwise allowable and reasonable. When the IHE is planning or contemplating new construction, however, the auditor should verify the IHE appropriately capitalizes the cost to the construction project in accordance with generally accepted accounting principles. The historical cost of an asset includes administrative and technical activities during the preconstruction stage, such as development of plans (ASC 360-10-30-1).

#### **13-709.5 Tuition Remission, Scholarships and Student Aid \*\***

a. Fringe benefits in the form of tuition or remission of tuition for individual employees are allowable if the benefits are granted in accordance with established policies and are distributed to all activities on an equitable basis ([2 CFR 200.431\(j\)](#)).

b. [§200.466](#) provides criteria for allowability of costs associated with scholarships and student aid. The auditor should review the IHE's relevant policies and procedures when costs are material, to determine if the IHE is complying with the requirements.

#### **13-709.6 Computer Facilities \*\***

The National Science Foundation (NSF) provides grants to IHEs to help defray the cost of acquiring or operating computer facilities to support nonsponsored research. Auditors should understand the terms and conditions of the NSF award to determine if there are any specific restrictions for use of the grant funding. Where there are no specific restrictions or conditions, the IHE may allocate costs for acquiring or operating a computer facility to major functions in a manner that is equitable.

#### **13-710 Work-Study Program Costs \*\***

a. Students may receive Federal support through the Federal work-study program administered by the Department of Education. The Uniform Guidance does not specifically address work-study related costs. The Department of Education establishes the regulations governing the work-study program for post-secondary education (34 CFR Subtitle B, Parts 600 through 699). [34 CFR 675.1 through §675.50](#) establish the regulations for post-secondary education work study programs. Audit procedures should focus on determining if the costs charged to Federal awards comply with the 34 CFR regulations, and are appropriately allocated to the Federal award, including:

(1) Students are paid on an hourly basis for actual time on the job, and fringe benefits are not counted as part of the wage rate. (This does not apply to graduate students for whom the IHE may pay in accordance with its usual practices.)

(2) The wage rate was at least equal to the minimum wage rate required under the Fair Labor Standards Act of 1938, section 6(a), and payment was not through a salary, commission, or fee ([§675.24](#)).

(3) The Federal share does not exceed 75 percent of the compensation, unless it meets certain criteria. Fringe benefits, employer's share of social security, workers' compensation, retirement, or other welfare or insurance program that the employer pays on behalf of the student

employee are not included in the Federal share ([§675.26\(b\)](#)). These restrictions apply even when the Department of Education authorizes a Federal share of 100 percent of the wages.

b. The auditor should verify that the portion of wages supported by the work-study grant are included in the appropriate allocation bases of the major functions where the work-study participants work. For example, the Federal costs related to a student working in a research lab should be included in the research and development function's allocation base and are not included as indirect costs of Federal awards.

### **13-711 Allocation [\\*\\*](#)**

a. The overall objective of the indirect cost allocation process is to distribute the indirect costs to major functions (as defined in 2 CFR 200, Appendix III, Section A.1) of the IHE in proportions reasonably consistent with the nature and extent of their use of the IHE's resources (2 CFR 200, Appendix III, Section A.2.b or Section D for small IHEs using the simplified method). This discussion applies to large IHEs, for small IHEs using the simplified method, see [section 712.2](#).

b. Appendix III, Section A.2 provides general criteria for distribution, Section B provides guidelines for intermediate distribution of specified cost groupings to major activities and functions, and Section C.2 provides criteria for establishing the final allocation bases for distributing the F&A costs to major functions.

c. Indirect costs for cost categories identified in Appendix III, Section B, must first be distributed in the order specified, unless the IHE uses an alternative provided for in Section A.2.d.

d. Indirect costs must be distributed to applicable Federal awards and other benefiting activities within each major function on the basis of modified total direct costs (MTDC). This is the final distribution base for each major function and must contain all the programs or activities that utilize the indirect costs allocated to that major function. Each major function will have separate indirect (F&A) cost rate.

#### **13-711.1 Base Period and General Criteria [\\*\\*](#)**

a. The base period for distribution of indirect costs is the period during which the costs are incurred. The base period normally coincides with the fiscal year established by the IHE. If a different base period is selected, it should ensure an equitable distribution of cost.

b. To achieve equitable allocation of cost, the IHE should develop appropriate indirect cost groupings (Appendix III, Section A.2.b). Cost groupings should be established considering Appendix III, Section A, and each pool or cost grouping should then be distributed using the distribution base or method most appropriate in light of the guidelines set forth in Appendix III, Section A.2.d.

c. The auditor should determine if all programs and activities are included in the distribution base for each major function and that the distribution provides an equitable distribution of cost to Federal awards.

#### **13-711.2 Allocation of Indirect Cost – Step-Down Process [\\*\\*](#)**

a. Order of allocation. Indirect costs for certain cost groups must be allocated to other cost groups as well as to the major functions and specialized service facilities of the IHE in a

specified order (Appendix III, Section A.2.e). This is commonly referred to as the “step-down” process. See [Figure 13-7-3](#) for an illustration of this process.

- (1) Depreciation
- (2) Interest expense
- (3) Operation and maintenance expense
- (4) General administrative and general expenses
- (5) Other cost categories may be allocated in the order determined to be most appropriate by the IHE.

b. An indirect cost category will be considered closed once it has been allocated to other cost objectives, and costs may not be subsequently allocated to it. The IHE may use a cross-allocation methodology to initially distribute indirect cost groupings, rather than through the order of distribution described above, when it results in a more equitable allocation of cost. The distribution of cost from one cost category to another does not change the nature of the item, however, and modification to the composition of the indirect cost categories is required.

### **13-711.3 Allocation to Final Cost Objectives [\\*\\*](#)**

a. An allocation base should be the one best suited for allocating the indirect costs in the cost grouping or pool to the cost objectives based on a causal or beneficial relationship, or on sound logic and reason when the benefit cannot be determined. For allocation of cost from major functions to final cost objectives (through the major function’s F&A rate) the IHE must use the method prescribed in Appendix III, Section C.2 for large IHEs (the Modified Total Direct Cost (MTDC) base) for large IHEs, and in Section D for small IHEs, which can be either the MTDC or salaries and wages allocation base.

#### **b. Modified Total Direct Cost Base (MTDC)**

(1) The MTDC allocation base must be used to allocate indirect costs to final cost objectives. Qualifying IHEs may use the simplified procedures in 2 CFR 200, Appendix III, Section D, which permits use of a simplified MTDC or a wages and salaries base. (See 13-615).

(2) Appendix III, Section C.2 prescribes that indirect costs be distributed to applicable Federal awards and other benefiting activities within each major function on the basis of MTDC. The MTDC base contains all direct salaries and wages, applicable fringe benefits, materials and supplies, services, travel and the up to the first \$50,000 of each subaward or subcontract. The MTDC base excludes equipment, capital expenditures, charges for patient care, rental costs, tuition remission, scholarships, fellowships, and participant support costs. With the approval of the cognizant agency for indirect costs, other items may be excluded only to avoid a serious inequity in the distribution of the indirect costs.

c. A separate F&A rate will be developed for each major function for allocation of indirect cost to final cost objectives.

### **13-711.4 Allocation to Major Functions and Intermediate Cost Objectives [\\*\\*](#)**

a. For distributing cost to major activities and functions, the IHE may use any methodology that is based on a causal or beneficial relationship and is otherwise equitable. In some cases, it may be necessary to selectively distribute cost by establishing separate cost



groupings within one or more cost categories identified in Appendix III, Section B, in order to provide equitable allocation of the cost.

b. This section discusses common methods for allocation.

#### **13-711.4.1 Cost Analysis Studies \*\***

a. A cost analysis study may be used to determine the allocation of indirect costs when the study meets the conditions required in Appendix III, Section A.2.d(3) and results in equitable distribution of cost.

b. Cost analysis studies cannot be used to determine the allocation base for utility and student services costs.

c. Section A.2.d(3) requires the cost analysis study provide for the following:

- (1) Be appropriately documented in sufficient detail for subsequent review,
- (2) Distribute costs to related cost objectives in accordance with the relative benefits derived,
- (3) Be statistically sound,
- (4) Be performed specifically at the IHE where the results are used,
- (5) Be reviewed periodically, but no less frequently than rate negotiations,
- (6) Be updated as necessary,
- (7) Be used consistently,
- (8) Any assumptions made in the study be stated and explained, and
- (9) Be fully justified

d. The auditor should determine if the study meets the conditions required by the Uniform Guidance. If the audit procedures indicate that the study does not result in equitable distribution of cost, the auditor should request the IHE demonstrate that the study results in more equitable distribution of cost than using the MTDC or other appropriate base. If the IHE cannot demonstrate the case study results in more equitable distribution of cost, determine the appropriate allocation using the requirements of Section B.

#### **13-711.4.2 Space Utilization \*\***

a. The space utilization base is used to allocate costs for an activity that either drives the need for the space, or otherwise uses and benefits from the space. The IHE should maintain adequate supporting records to demonstrate that the use of space provides for equitable distribution of the indirect costs.

b. The period used to develop the space utilization base should be representative of the usage during the entire period.

c. When appropriate, the auditor should request assistance from Government technical personnel. See Appendix B for guidance on requesting and using the work of technical specialists.



### **13-711.4.3 Population Served [\\*\\*](#)**

The population served base should include all individuals that received benefit from the activities generating the indirect costs, including institutional personnel, all students, as well as the general public. Students should be included regardless of whether they attend full-time, part-time, evenings or summer only, are extension students, etc. The auditor should determine if the population included in the base is complete, and is appropriately weighted (for example, grouping all part-time individuals and recalculating as FTEs, rather than including each person as an individual regardless of the amount of time they are involved in the activity).

### **13-711.4.4 Allocation of Depreciation Expense [\\*\\*](#)**

Allocation of depreciation expense for buildings and equipment will typically be based on space utilization. The auditor should verify that depreciation expense was apportioned to the major functions in a manner that results in equitable distribution of the cost to the final cost objectives. For example, if depreciation expense is combined into a single cost grouping and allocated using salaries and wages, the auditor should verify that the depreciation expense was adjusted appropriately to account for student usage of classrooms, auditoriums, laboratories, etc.

## **13-712 Establishing Indirect Cost Rates at Educational Institutions (2 CFR 200, Appendix III) – Simplified Procedure [\\*\\*](#)**

This section discusses methods that Government agencies use to establish indirect cost rates for grants and contracts at IHEs and the contract audit responsibilities involved in the process. Small IHEs that expend \$10 million or less in direct Federal funds in a fiscal year may use simplified procedures to establish their indirect cost rates. The simplified procedures are discussed in [712.2](#). The remainder of this section focuses on establishing the indirect rates using the regular method.

### **13-712.1 Introduction [\\*\\*](#)**

a. The F&A cost rate process must be designed to ensure that the Federal government does not, in any way, subsidize the indirect costs of other non-Federal entities, specifically activities sponsored by industry and foreign governments. Each allocation method used to identify and allocate indirect cost pools must contain the full amount of the IHE's modified total costs or other appropriate unit of measurement to make the computations (2 CFR 200, Appendix III, Section C.1.a(3)). In some instances, a single rate for a major function may not be appropriate and a separate indirect cost pool may be necessary. Separate rates should be developed during the regular course of the rate determination process. For example, a single rate for the research function might not take into account the different environmental factors or other conditions that may substantially affect the indirect costs applicable to a particular segment of research at the IHE.

b. An IHE may perform on both research and non-research awards. Regardless of the type of negotiated indirect rates, the auditor should perform procedures to determine if the allocation of indirect cost is equitable. This includes considering the IHE's activities and related indirect cost rate structure and the materiality of undesirable effects of distribution of particular indirect cost. If audit procedures indicate the rates are inappropriate, or otherwise contributing to a significant inequity, the auditor should notify the cognizant federal agency for indirect costs to discuss the concerns.

c. See also [section 500](#) for general information related to many of the concepts included

in here. For example, additional information on auditing indirect rates and types of negotiated rates.

### **13-712.2 Simplified Method \*\***

a. IHEs that expend \$10 million or less in direct Federal funds in a fiscal year are considered to be small IHEs and the Uniform Guidance provides for somewhat less restrictions related to indirect cost allocation. Small IHEs must still comply with the rest of the Uniform Guidance. This subsection discusses the simplified procedures permitted by the Uniform Guidance for F&A cost allocation for small IHEs.

b. The simplified procedures are intended to reduce the burden on small IHEs and require that the IHE's most recent annual financial report and immediately available supporting information be utilized as a basis for determining the indirect cost rate applicable to all Federal awards.

c. The simplified procedures in 2 CFR 200, Appendix III, Section D permit indirect (F&A) cost rates be established using either a simplified MTDC or a salaries and wages base. Both are discussed below.

d. Audit effort will generally be reduced when an IHE uses the simplified procedures rather than the regular procedures. However, if the auditor finds that the simplified procedures result in inequitable allocation of cost to the Federal government, or to the IHE, the allocation of indirect cost should be determined using the regular procedures. This may happen at any point during the audit, for example, during review of the IHE's financial reports if the auditor finds supporting information is unavailable or inconsistent with the financial reports.

#### **13-712.2.1 Simplified Procedure - Salaries and Wages Base \*\***

a. To use the salaries and wages distribution base (2 CFR 200, Appendix III, Section D.2), the IHE must first establish the total amount of direct and indirect salaries and wages paid to all employees of the IHE. The allocation base is derived by subtracting the indirect salaries and wages that are included in the indirect (F&A) cost pool from the total salaries and wages.

b. The IHE will establish a single indirect cost pool that consists of expenditures customarily classified as general administration and general expenses, operation and maintenance, library, department administration, etc. The cost pool must exclude capital items and cost specifically identified as unallowable. The following conditions apply:

(1) General administration and general expenses must exclude costs for student administration and services, student activities, student aid, and scholarships,

(2) Operations and maintenance of physical plant and depreciation must be appropriately adjusted for costs applicable to institutional activities,

(3) Departmental administration expenses are limited to 20 percent of the salaries and expenses of deans and heads of departments. Where these types of costs have previously been classified as other institutional activities, they may be included in the F&A cost pool. Additionally, the total amount of salaries and wages included in the F&A cost pool must be separately identified from the other indirect costs.

c. The auditor should perform procedures to determine if:

(1) Specifically unallowable costs and capital items are excluded from the indirect

cost pool,

(2) Costs are based on the most recent financial report,

(3) The cost pool has been established in accordance with the conditions identified in b.(1) through b.(3) above,

(4) The total amount of indirect salaries and wages included in the cost pool have been deducted from the total salaries and wages to arrive at the distribution base.

(5) The F&A rate is accurately derived and appropriately applied to all Federal awards.

#### **13-712.2.2 Simplified Procedure – Modified Total Direct Cost Base \*\***

a. Using the simplified procedure for modified total direct cost (MTDC) base (2 CFR 200, Appendix III, Section D.3), the IHE will establish a single F&A rate rather than a separate rate for each major function. The MTDC base must include all of the IHE's direct functions.

b. The IHE must establish the total costs incurred by the IHE for the base period. The MTDC distribution base must consist of the costs identified in Appendix III, Section C.2, which includes all direct salaries and wages, fringe benefits, materials, supplies, services, travel, and the first \$50,000 of each subaward/subgrant.

#### **13-712.3 Educational Service Agreements \*\***

Educational service agreements may be established as part of the IHE's general instructional activities. If the service agreements require the establishment of actual indirect cost rates, additional analysis would be required to determine if the cost rates are consistent with any limitations or ceilings applicable to the administration costs, and to determine if the allocation of the cost is equitable to all awards in the general instruction function. For example, services may be related to the education of the general student body and not to specialized educational services rendered under specific awards.

#### **13-712.4 Indirect Cost Rates \*\***

a. Indirect cost rates are typically negotiated in advance of the periods they are used based on costs incurred in the most recently completed fiscal year (base year). The rates can be used for two to four years and some rates may be extended up to five years with approval of the cognizant agency for audit. Final F&A rates can be negotiated as predetermined, fixed with carry-forward provisions, provisional, final or the de minimis rate. This section discusses each type of rate and general audit activities the auditor should consider.

b. During an audit of an IHE's indirect cost rates, regardless of the type of rate, the auditor should determine if the costs included in the pools and bases are allowable, appropriately classified as direct or indirect cost, and are likely to result in equitable distribution of cost for the years the rate will be used.

##### **13-712.4.1 Predetermined Rates \*\***

a. Predetermined rates are presented in 2 CFR 200, Appendix III, Section C.4. Title [41 U.S.C 4708](#) authorizes the use of predetermined rates for research agreements with IHEs. The objectives of the law are to simplify the administration of cost-type research and development awards with IHEs, facilitate the preparation of the IHE's budgets, and expedite closeout of

awards.

b. Rates are established for a period of two to four years and can be used when the parties involved can reach an informed judgment as to the probable level of indirect costs during the years the rates will be used.

c. Predetermined rates carry the highest level of risk due to the fact that no adjustment will be made based on actual cost experience. The auditor should consider factors that may indicate the rate will not be equitable in subsequent years. For example, the rate may not equitably distribute cost in the future if the IHE acquires or loses substantial work in a particular function as compared to other functions, if the IHE is planning to increase or decrease instructional programs, or is planning to implement or stop other institutional activities, such as starting or curtailing cafeteria services, adding new areas of instruction, completing buildings that are currently under construction, etc.

d. During incurred cost or other types of audits, the auditor should determine if the IHE appropriately applies the predetermined rate consistently. If the auditor becomes aware, during subsequent audit effort, that the IHE is treating costs differently as either direct or indirect cost as compared to the classification of the cost for the negotiated rate, the auditor should consider if this is a CAS 502 noncompliance and follow the guidance in Chapter 8-302.7c.

#### **13-712.4.2 Fixed Rates and Carry-Forward Provisions \*\***

a. Fixed rates and carry-forward provisions are discussed in 2 CFR 200, Appendix III, Section C.5. The fixed rate is applied to awards and is not adjusted for over- or under-recovery of indirect cost. The amount of over or under recovery of indirect cost will be applied to subsequent year indirect rates. In the event a fixed rate is negotiated before the carry-forward adjustment is determined for the prior period, the adjustment may be applied to the next subsequent rate negotiation.

b. The carry-forward adjustment from the prior period is applied to the proposed distribution base to arrive at the negotiated fixed rate. Unrecovered amounts under lump-sum agreements or cost-sharing provisions of prior years must not be carried forward for consideration in the new rate negotiation.

d. The cognizant agency for indirect costs and the IHE must agree in advance whether the differences between the fixed rate and the actual cost incurred will be considered in rate negotiation rather than making that determination after the differences are known.

e. IHEs electing to use carry-forward provisions must obtain prior approval from the cognizant agency for indirect costs before changing to a post-determined rate. If the IHE returns to a post-determined rate, any over- or under-recovery during the period where the fixed rate was used will be included in the subsequent post-determined rate.

f. The auditor should verify that the IHE appropriately applies fixed rates to all awards. Additionally, DCAA may provide audit support to determine the amount of the carry-forward at the request the cognizant agency for indirect costs.

#### **13-712.4.3 Provisional and Final Rates \*\***

a. Provisional and final rates are addressed in 2 CFR 200, Appendix III, Section C.6. Provisional rates are used only when: 1) The cognizant agency for indirect costs determines factors exist that do not justify the use of predetermined or fixed rates with carry-forward, or 2)

the IHE and cognizant agency for indirect costs cannot agree on an equitable rate. To prevent substantial over- or under-payment of cost, the provisional rate may be adjusted by the cognizant agency for indirect costs during the IHE's fiscal year.

b. A provisional rate may be replaced with a predetermined or fixed rate at any time prior to the close of the fiscal year. If a provisional rate is not replaced by a predetermined or fixed rate, a final rate will be established and upward or downward adjustments will be made based on the actual allowable costs incurred for the period involved.

c. The auditor should verify that the IHE appropriately applies the provisional rate, and notify the cognizant agency for audit if it appears the provisional rate will result in substantial over- or under-payment of cost for the fiscal year.

#### **13-712.4.4 De Minimis Rate \*\***

IHEs that have never had a negotiated indirect cost rate may elect to use a de minimis rate of 15 percent of the modified total direct costs ([2 CFR 200.414\(f\)](#)). If an IHE uses the de minimis rate they must comply with [§200.403](#), which requires costs:

- Be necessary and reasonable for the performance of the award,
- Conform to any limitations or exclusions in the cost principles or terms and conditions of the awards,
- Be consistent with the IHE's policies and procedures to apply costs uniformly to both Federally and non-Federally funded activities,
- Be treated consistently as either direct or indirect cost in like circumstances,
- Be determined in accordance with GAAP (or the applicable standards for state and local governments and Indian tribes).
- Not be included as a cost or used to meet cost sharing requirements of any other Federally-financed program in either the current or a prior period,
- Be adequately documented.

#### **13-713 Selected Areas of Cost – Considerations for Educational Institutions \*\***

##### **13-713.1 Introduction \*\***

This section addresses cost principles specified in 2 CFR 200, Subpart E that provide allowability criteria specific to IHEs. [Section 507](#) provides general guidance for selected areas of cost that are applicable to all types of entities covered by 2 CFR 200, Subpart E.

##### **13-713.2 Compensation \*\***

a. In addition to the criteria for allowability discussed in [section 507.5](#), [§200.430\(i\)](#) provides additional criteria specific to IHEs. Certain conditions require special consideration and possible limitations in determining allowable compensation under Federal awards. These include:

(1) Allowable activities. Charges to Federal awards may include reasonable amounts for activities contributing directly to work under an agreement (§200.430(i)(1)(i)).

(2) Documentation of supplemental compensation for incidental activities that are

allowable under the IHE's written policy. Rates that do not exceed the institutional base salary (IBS) do not need to be described in the records required for documentation of personnel expenses (§200.430(i)). The IBS is the annual compensation paid by the IHE for the individual's appointment, whether their time is spent on research, instruction, administration, or other activities. To be allowable, the activities must either be specifically provided for in the Federal award budget, or have prior written approval by the Federal agency.

b. Costs for salaries for faculty members during the academic year are allowable at the IBS rate (except see bullet a(2) above). The charges to a Federal award for compensation shall not exceed the proportionate share of the IBS for the period, unless specifically provided for under the Federal award or with written approval by the Federal agency.

c. See §200.430(i)(3) through (i)(8) for criteria related to:

- Intra-institution consulting – (i)(3)
- Extra service pay – (i)(4)
- Periods outside the academic year – (i)(5)
- Part-time faculty – (i)(6)
- Sabbatical leave costs – (i)(7)
- Non-faculty members – (i)(8)

d. Sabbatical leave costs are allowable only when the IHE has a uniform written policy on sabbatical leave (see 2 CFR 200.430(i)(7)). Sabbatical leave may be treated as direct or indirect cost depending on the circumstances. The auditor should review the IHE's policy on sabbatical leave and determine if the IHE policy is compliant with the Uniform Guidance and that the IHE treats similar costs consistently.

### **13-713.3 Fringe Benefits \*\***

a. In addition to the criteria discussed in [section 507.6](#), the auditor needs to consider the conditions applicable to IHEs in [§200.431\(j\)](#).

b. Fringe benefit costs (such as pension and insurance) paid by a state or local government on behalf of the IHE are allowable whether or not these costs are recorded in the IHE's accounting records if the costs are:

- (1) Compliant with the Uniform Guidance cost principles,
- (2) Properly supported by approved cost allocation plans, and
- (3) Not otherwise borne directly or indirectly by the Federal government.

### **13-713.4 Interest \*\***

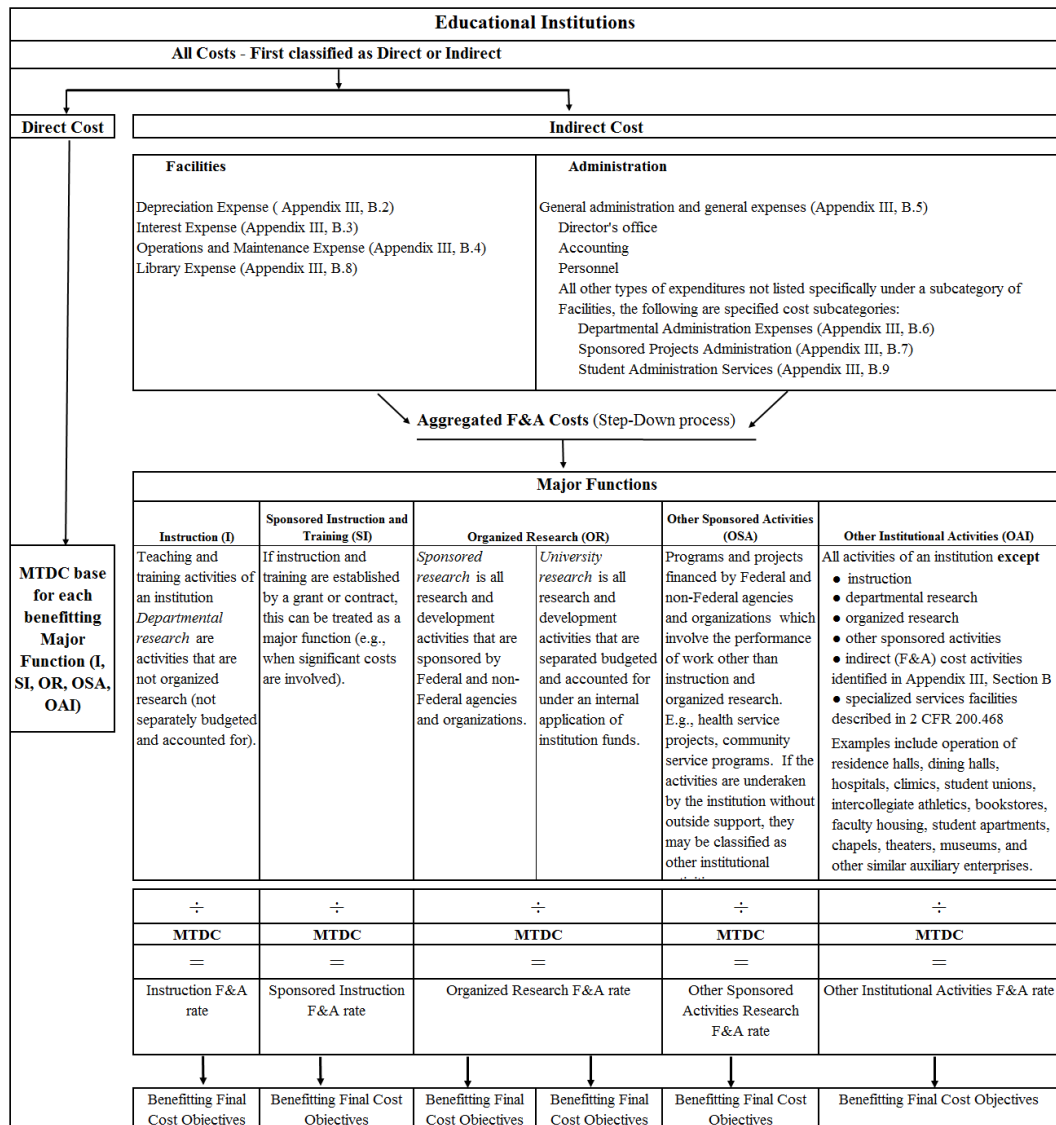
In addition to the allowability criteria discussed in [section 507.4](#), interest costs are allowable if the IHE incurred the costs after September 23, 1982 in connection with the acquisition of capital assets that occurred after that date.



**Figure 13-7-1 F& A Cost Categories - Universities \*\***

Indirect Cost	
Facilities	Administration
Depreciation Expense ( Appendix III, B.2) Interest Expense (Appendix III, B.3) Operations and Maintenance Expense (Appendix III, B.4) Library Expense (Appendix III, B.8)	General administration and general expenses (Appendix III, B.5) Director's office Accounting Personnel All other types of expenditures not listed specifically under a subcategory of Facilities, the following are specified cost subcategories: Departmental Administration Expenses (Appendix III, B.6) Sponsored Projects Administration (Appendix III, B.7) Student Administration Services (Appendix III, B.9)

**Figure 13-7-2 F& A Allocation Flowchart Illustration for Educational Institutions \*\***





**Figure 13-7-3 Indirect Cost Allocation – Step-Down Process \*\***

<b>STEP DOWN SCHEDULE</b>												
<b>Cost Group</b>	<b>Total Cost</b>	<b>Bldg Depr</b>	<b>Equip Depr</b>	<b>Interest</b>	<b>O&amp;M</b>	<b>GA</b>	<b>DA</b>	<b>SPA</b>	<b>SSA</b>	<b>LIB</b>	<b>UA</b>	<b>Total</b>
<b>INDIRECT POOLS</b>												
Bldg Depr	2,900	(2,900)										
Equip Depr	800	0	(800)									
Interest	300	0	0	(300)								
O&M	5,500	40	10	0	(5,550)							
General Admin	1,800	25	20	0	55	(1,900)						
Departmental Admin	3,800	100	25	5	180	160	(4,270)					
Sponsored Projects	1,800	5	5	3	10	20	1	(1,844)				
Student Services	1,700	50	10	0	80	60	95	0	(1,995)			
Library	1,400	150	5	0	170	50	1	0	0	(1,776)		
Unallowable	1,700	0	0	0	5	10	0	0	0	0	(1,716)	0
<b>MAJOR FUNCTIONS</b>												
Instruction	18,000	1,200	280	110	1,900	750	2,170	1,505	1,995	1,000	0	28,910
Organized Research	7,000	450	260	140	900	300	1,015	120	0	80	0	10,265
Other Sponsored Act	5,300	80	15	5	170	250	600	220	0	140	0	6,780
Other Institutional Act	6,900	800	170	40	2,080	300	390	0	0	550	1,716	12,946
<b>TOTAL Allocated Indirect Cost</b>	<b>58,900</b>	<b>(0)</b>	<b>0</b>	<b>3</b>	<b>0</b>	<b>0</b>	<b>2</b>	<b>1</b>	<b>0</b>	<b>(6)</b>	<b>0</b>	<b>58,900</b>

### **13-800 Uniform Guidance Annual Audit (Formerly OMB Circular A-133, or Single Audits) \*\***

#### **13-801 Introduction \*\***

a. This section provides guidance on performing the compliance audit portion of the annual single audit required by [2 CFR 200, Subpart F – Audit Requirements](#). A non-federal entity exceeding the statutory threshold of Federal awards must have either a single or program-specific audit performed. For purposes of this section, “single audit” will be used to refer to either, unless specifically identified as relating to one or the other type audit. DCAA efforts as part of the annual audit are performed under the 10110 activity code. DCAA participates in the compliance audit portion of the annual audit in coordination with the auditee’s independent public accounting (IPA) firm that conducts the financial statement audit.

b. The Single Audit Act was enacted in 1984 to require an annual organization-wide financial and compliance audit for recipients of Federal awards. The Federal Office of Management and Budget (OMB) issued several circulars to clarify grant administration and audit requirements. On December 26, 2014, several circulars were consolidated into 2 CFR 200 (Uniform Guidance). The requirements for the annual audit, contained in 2 CFR 200, Subpart F, became effective for audits of auditee fiscal years beginning on or after December 26, 2014.

c. The guidance for reporting included in this section supplements the information presented in Chapter 10 and applies to audit reports for all organizations covered by the Uniform Guidance requirements, including IHEs, Federal Funded Research and Development Centers (FFRDCs), and other nonprofit organizations.

d. An audit conducted in accordance with 2 CFR 200, Subpart F, must be in lieu of any other financial audit of Federal awards. To the extent that the audit provides a Federal agency with the information necessary to carry out its responsibilities under Federal statute or regulation, a Federal agency must rely upon and use that information.

### **13-802 Relationship to Other Audits \*\***

a. The Uniform Guidance, including its implementation of the Single Audit Act (31 U.S.C. 7501-7507), requires federal agencies when planning audits, to ensure that the audits are not duplicative of other audits of federal awards (2 CFR 200.503). To accomplish this, the federal agency (or pass-through entity) must review the Federal Audit Clearinghouse (FAC) website for recent audits submitted by the entity. Any additional planned audits must rely and build upon the work performed in the single audit. This includes the audit documentation, sampling and testing already performed to the extent it meets the federal agency's needs. Federal agencies must pay for any financial audits performed in addition to the single audit (2 CFR 200.503).

b. The Single Audit Act (31 U.S.C. 7501-7507), as implemented by the Uniform Guidance, does not prohibit DCAA from performing different types of audits (i.e. systems, CAS, etc.), under most circumstances as described in this paragraph. When Federal agencies require audits in addition to the annual single audit, in part a. above. The audit team must work with the requestor to obtain an understanding of their needs and determine the scope of the audit. If a single audit has been performed on the same scope of audit; the auditor must coordinate with the requestor to determine whether the single audit does or does not meet their needs. Further, the audit team should consider the audit procedures performed for the single audit and any findings reported. This may require obtaining access to the independent accounting firm's (i.e., the IPA or State Auditor's Office as applicable) working papers to determine if the procedures performed were sufficient for the needs of the audit, and determining whether that work can be used to design audit procedures. Audit teams are to follow the guidance in 4-1000.

### **13-803 Coordinated Audit Approach \*\***

a. DCAA participation in the annual audit subject to the Uniform Guidance is performed in coordination with the independent audit firm (IPA) hired by the auditee to perform the financial statement audit. This approach requires DCAA (including Field Detachment, if necessary) and the IPA to meet and coordinate audit responsibilities and milestones to enable the auditee to meet its reporting requirements. The auditor should maintain documentation in the working papers for all activities related to the coordination of the audit.

b. Each audit entity will report on internal control related to the compliance requirements for which they are responsible, report an opinion on compliance for each major program tested, and prepare a schedule of findings and questioned costs for findings identified during the audit procedures.

c. Due to DCAA's limitation on providing audit services to non-DoD agencies that do not participate in the costs of the audit, DCAA may not provide audit services for awards to non-DoD agencies. Because the Uniform Guidance compliance audit must cover the entire operations of the auditee, the auditor will need to closely coordinate with the IPA to ensure all awards are covered by the audit for compliance requirements for which DCAA is responsible.

d. The "coordinated audit approach" is not synonymous with the DCAA one-audit approach. DCAA cannot use the "one-audit" approach with the IPA. If the auditor intends to use the work

of the IPA auditor, or the auditee's internal audit staff, follow the guidance in [4-1000](#).

### **13-803.1 Initial Coordination \*\***

Coordination of the audit with the IPA generally requires the following activities:

(1) An initial planning/coordination meeting should be held that includes DCAA, the IPA firm, and the auditee. The auditor should invite the ACO to attend the meeting to help ensure the audit scope is responsive to the needs of the cognizant Federal agency. The intent of the meeting is to discuss, agree-to, and document each firm's audit and reporting responsibilities to eliminate duplication of effort. The responsibility for completing the auditor's portion of the data collection form (see section [804](#) for discussion of the data collection form) should be agreed upon with the IPA during the initial coordination meeting or other appropriate time. If the IPA assumes this responsibility, it will include ensuring that DCAA audit findings are incorporated in the form, and DCAA should verify that DCAA findings are appropriately included. If the DCAA auditor will be relying on the work of the IPA or other non-DCAA auditors, discussion should include procedures for obtaining access to the IPA working papers and information about those individual's training and professional credentials.

(2) During the initial meeting, the firms will identify the major programs subject to audit, along with the applicable direct and material compliance requirements, and agree to the distribution of responsibilities for audit coverage and reporting. The discussion should include review of the OMB compliance supplement (2 CFR 200, appendix XI) corresponding to the auditee's fiscal year under audit to identify the compliance requirements that have a direct and material effect on each major program subject to audit. The coordinated audit matrix template included with the 10110 standard working papers should be used to facilitate the discussion and document the outcome of the responsibilities agreed-to at this meeting (see [Figure 13-8-1](#) for an example coordinated audit matrix).

(3) Inform the auditee, the IPA, and the ACO of any non-DoD Federal awards that will be excluded from the DCAA audit scope. The coordinated audit matrix should clearly identify who will be responsible for providing audit coverage of the non-DoD awards excluded from DCAA scope of audit.

### **13-803.2 Coordination Activities \*\***

a. Following the plan for responsibilities established during the initial meeting, each audit firm will perform audit procedures related to internal control and compliance, and report on the portions of the audit scope for which they accepted responsibility.

b. To ensure that the audit is completed in time for the auditee to meet reporting requirements, DCAA and the IPA should plan and maintain ongoing communication throughout the audit regarding status/progress and issues that may arise during the audit in order to ensure the combined audit plans result in an effective audit process with minimal duplication of effort.

c. When the FAO and Field Detachment have joint audit responsibilities, the objective should be to achieve a comprehensive, integrated audit of the recipient's Federal expenditures. This generally requires annual coordination meetings in advance of the coordination meeting held with the IPA. See 6-103.2 for guidance in coordinating audit activities between FAOs and Field Detachment.

d. Audits of classified or non-DoD agency awards may be performed by other

Government audit organizations. Where classified work is involved, the FAO should request assistance from Field Detachment, who will coordinate with the other Government audit organization and perform procedures necessary for determining reliance on the work of others following the guidance in Appendix B.

e. If the auditor intends to rely on work performed by the auditee's internal audit personnel or non-DCAA Government technical specialists, for example Government individuals that are part of a business system review team, the auditor must evaluate the work performed by following the guidance in 4-1000 and Appendix B.

### **13-804 Annual Audit – Auditee Reporting Requirements \*\***

a. A non-federal entity that expends Federal awards in excess of the statutory threshold during a fiscal year, as either a recipient or subrecipient, must have an annual single audit performed in accordance with the provisions of Subpart F. An entity is a recipient or subrecipient under a Federal award when the award requires the entity to carry out part of the Federal award, which requires the auditee to comply with the terms and conditions of the Federal award, and does not apply to vendors or contractors providing only goods and services for the non-federal entity's use in carrying out the program. Payments received for providing goods to the awarding agency or a pass-through entity for the agency's or pass-through entity's personal use, are not considered Federal awards. The substance of the agreement is the determining factor for classifying an agreement as either a Federal award or a contract for goods and services. The auditor should verify that the entity appropriately identified all Federal awards in the Schedule of Federal Expenditures, and excluded procurement-type awards for goods and services (discussed in [section 807](#)).

b. 2 CFR 200, Subpart F, establishes the annual single audit and reporting requirements for nonprofit organizations, IHEs, states and local governments, and Native Tribal governments. The auditee is responsible for submitting the required documents to the Federal Audit Clearinghouse (FAC) within the established timeframes to meet the reporting requirements ([§200.508\(a\)](#)), which requires submission of the reporting package within 30 days after receiving all audit reports, or within 9 months after the end of the period subject to audit, whichever comes first.

c. The reporting package must contain the audited financial statements ([§200.510](#)), the schedule of expenditures of federal awards ([§200.510\(b\)](#)), a summary schedule of prior audit findings ([§200.511\(b\)](#)), the audit report on the financial statements, report on internal control over compliance with Federal programs, the report on compliance with Federal programs ([§200.515](#)), and the auditee's corrective action plan addressing audit findings identified in the audit report ([§200.511\(c\)](#)).

d. When the auditee expends Federal awards under only one Federal program (excluding R&D programs), and the Federal program's statutes, regulations, or terms and conditions of the award do not require a financial statement audit of the auditee, the auditee may elect to have a program-specific audit performed in accordance with [§200.507](#). A program specific audit for R&D can only be performed if all of the Federal awards expended were received from the same Federal agency or pass-through entity. See [section 819](#) for discussion of program specific audits.

e. If the auditee owns or operates a Federally Funded Research and Development Center (FFRDC), the auditee may elect to treat the FFRDC as a separate entity for purposes of the annual audit ([§200.501\(e\)](#)), in which case the expenditures by the FFRDC would be excluded

from the auditee's reporting package and submitted as a separate reporting package to the FAC. Audits of FFRDCs is discussed in [section 900](#).

f. The reporting package, including the audit report, must be available for public inspection. Beginning in 2017, the FAC provides access to the general public for all audit packages submitted. Auditors should keep this in mind when developing the audit report and exhibits and strive to exclude proprietary information from the audit report. The report and audit findings should be presented at a high level and the detailed working papers supporting the audit report findings provided directly to the cognizant agency for indirect rates in a memorandum rather than as an exhibit or attachment to the audit report. For example, the audit exhibit reporting questioned costs or rates should report only the amount/rate percentage questioned, and not include the amount/rate proposed or the audit-adjusted amounts/rates. Additionally, personally identifiable information should never be included in the audit report. The auditor should maintain a record of correspondence with the cognizant agency for indirect rates in the working papers.

### **13-805 Auditor Responsibilities – Introduction [\\*\\*](#)**

a. This section provides an overview of the auditor's responsibilities while conducting the Uniform Guidance compliance audit, as specified in §200.514 through 200.520. The auditor may be a Federal auditor, or an independent public accountant. The results of the compliance audit are submitted with the audit report on the financial statements performed by the independent public accounting firm (IPA) procured by the auditee. DCAA involvement in the annual single audit is generally limited to the compliance audit portion of the audit, including testing of internal control over compliance with Federal programs. DCAA auditors will need to work closely with the IPA to identify the direct and material compliance requirements that will be audited by each organization in a manner that ensures the auditee's entire operations are covered by the total audit activities, and to ensure that DCAA audit findings are appropriately reported in the data collection form.

b. The audit must be conducted in accordance with Generally Accepted Government Auditing Standards (GAGAS, or the Yellow Book). Because the compliance audit is part of a financial audit, GAGAS Chapter 4 is applicable to the compliance audit rather than GAGAS Chapter 5. Additionally, AU-C 935 is also applicable to the compliance portion of the audit.

c. The audit must cover the entire operations of the auditee. But see [§200.514](#) for circumstances where the auditee elects to have a series of audits performed to cover its departments, agencies, and other organizational units.

d. In performing the compliance audit, the auditor must also consider the risk of fraud (see [section 813](#)). The auditor should develop an appropriate audit scope and conduct a quality audit. The planning of the audit should ensure the following audit objectives are met:

- Performing the audit in accordance with GAGAS,
- Assessing internal control over compliance with Federal program requirements, and reporting on internal control over compliance (See [section 814](#)),
- Determining compliance with Federal statutes, regulations, and the terms and conditions of Federal awards, and reporting compliance in the Schedule of Findings and Questioned Costs (See [section 815](#)),
- Assessing whether the auditee's summary schedule of prior audit findings materially



represents the actual status of the prior audit findings (See [section 812](#)).

e. Performing the audit requires the auditor to:

- (1) Determine the level of auditee risk (See [section 808](#) for discussion)
- (2) Determine program risk (See [section 809](#) for discussion)
- (3) Determine major programs for testing compliance using the risk-based approach (See [section 810](#) for discussion).
- (4) Maintain adequate audit documentation (See [section 811](#) for discussion)
- (5) Reporting audit findings (See [section 812](#) for discussion).
- (6) Submission of the Audit Report(s) as part of the Reporting Package (See [section 817](#) for discussion).

### **13-806 OMB Compliance Supplement \*\***

a. The OMB compliance supplement (the Supplement) (2 CFR 200, Appendix XI) provides guidance related to performing the annual single audit and is updated on an annual basis and must be considered during the performance of the annual single audit performed in accordance with 2 CFR 200. The auditor should review the Supplement applicable to the fiscal year under audit and is responsible for achieving the stated audit objectives for compliance requirements applicable to the Federal program(s) subject to audit.

b. The Supplement provides the principal compliance requirements for major programs that Federal agencies expect to be considered as part of the annual single audit. The Supplement assists auditors to understand the Federal program objectives, provides recommended procedures for performing tests for each compliance requirement relevant to the audit objective for determining compliance with Federal programs. For programs not included in the Supplement, the auditor should review the Federal award and applicable regulations and determine if a program-specific guide is available from the Office of the Inspector General of the Federal agency. When a current program-specific audit guide is not available, the auditee and auditor must have basically the same responsibilities for the Federal program as they would have for an audit of a major program in a single audit ([§200.507\(b\)\(1\)](#))

c. The auditor must determine the applicable compliance requirements for each major program tested and design appropriate audit procedures to assess test internal control and test for compliance.

### **13-807 Schedule of Expenditures of Federal Awards (SEFA) \*\***

a. The auditee is required to prepare a SEFA for the period covered by the auditee's financial statements ([2 CFR 200.510\(b\)](#)). The SEFA is a schedule of expenditures by major program, non-major program, loans, and non-cash assistance that accompanies the financial statements. The IPA reporting on the financial statements will report on whether the SEFA is stated fairly in all material respects in relation to the financial statements. The SEFA must include the total Federal award expended (see §200.502 for determining expenditures) and include the following information at a minimum:

- (1) List individual Federal programs by Federal agency using the applicable Assistance Listing number(s). For a cluster of programs, the individual Federal programs within the cluster

must include the cluster name, applicable Federal agency names, and the applicable Assistance Listing number(s). For research and development, for example, total Federal awards expended must be shown either by individual Federal award, or by Federal agency and major subdivision of the agency.

(2) The name of pass-through entities and identifying award numbers for expenditures made as a subrecipient.

(3) Total Federal awards expended for each individual Federal program, and the CFDA number, or other identifying number if the CFDA is not available. For a cluster of programs, the total expenditures for the cluster must also be shown.

(4) The total amount provided to subrecipients from each Federal program.

(5) Notes that describe the significant accounting policies used to prepare the schedule, and whether the auditee elected to use the 15% de minimis cost rate (see §200.414). For loan or loan guarantee programs (see §200.502) the notes must also include a schedule of balances outstanding at the end of the audit period in addition to the amount expended for loan and loan guarantee programs.

b. The auditor should verify that the information in the SEFA is complete, and determine if audit assistance is required, for example when there are classified awards or an assist audit is needed due to the location of records for Federal awards.

### **13-808 Determining Auditee Risk Level \*\***

a. During the preliminary stage of the audit, the auditor must assess whether the auditee may be considered a low-risk auditee, or other than low-risk auditee. The 10110 standard audit program contains a working paper to facilitate this determination. During the initial coordination meeting, DCAA and the IPA should agree on whether auditee is considered to be a low-risk auditee.

b. When an auditee is considered to be a low-risk auditee, the percentage of coverage rule requires testing of major programs that encompass at least 20 percent of the total Federal awards. When an auditee is considered other than low-risk, the testing of major programs must encompass at least 40 percent of the total Federal awards expended.

c. The criteria for determining whether an auditee is eligible to be considered low risk is contained in §200.520 and requires all of the following conditions to be met in the two preceding audit periods:

(1) Single audits were performed on an annual basis, including submission of the data collection form and reporting package to the FAC within the timeframe required by §200.512.

(2) There were unmodified opinions on whether the financial statements were prepared in accordance with GAAP and the SEFA in-relation-to opinion.

(3) No material weaknesses in internal control were reported under the requirements of GAGAS.

(4) The auditor did not report substantial doubt about the auditee's ability to continue as a going concern.

(5) None of the Federal programs classified as Type A programs had audit findings



reporting:

- Material weaknesses in internal control for major programs reported in the internal control report,
- Modified opinion on a major program, or
- Known or likely questioned costs exceeding five percent of the total Federal awards expended for a Type A program.

### **13-809 Determining Federal Program Risk \*\***

a. In determining Federal program risk, the auditor should evaluate the overall risk of noncompliance that could be material to the program. The auditor should consider the input of auditee management, the Federal agency, or the pass-through entity. In assessing Federal program risk the auditor should review §200.519.

b. The auditor should consider current and prior audit experience, oversight exercised by Federal agencies or pass-through entities, and inherent risk in the Federal program.

c. Current and prior audit experience related to weaknesses in internal control over Federal programs could indicate higher risk. The control environment may also indicate factors such as management's expectations in adhering to Federal statutes, regulations, and the terms and conditions of the awards, as well as competence and experience of personnel administering Federal programs.

d. A Federal program administered under multiple internal control structures may have a higher risk. For example, the auditor should consider whether weaknesses identified are isolated to a single operating unit, such as one college campus, or are pervasive throughout the entity.

e. Prior audit findings would indicate higher risk, particularly when the findings have a significant impact on a Federal program or have not been corrected.

f. The auditor should consider oversight activities performed by Federal agencies or pass-through entities. For example, recent monitoring by an oversight entity that identified problems during monitoring activities may indicate a higher risk.

g. Federal programs have inherent risk. The auditor should consider such things as:

(1) Complexity of the program and the type of service provided (see §200.519(d)(1)).

(2) A program that is new to the auditee, or where there are new or interim regulations may indicate a higher risk than an established program with time-tested regulations. For example, the Uniform Guidance now contains procurement system requirements that non-Federal entities must comply with. A newly implemented procurement system may have higher risk if it is significantly different from the prior procurement system or practices.

(3) Risk might be higher during the first and last years of a Federal program due to start-up or closeout activities that are not a normal part of the administration of the program.

### **13-810 Major Program Determination \*\***

a. The Uniform Guidance does not require testing of all major Federal programs. It does require auditors to use a risk-based approach to determine which Federal programs will be audited as major programs for each annual audit. [2 CFR 200.518](#) provides the requirements for

using the risk-based approach in determining major programs.

b. The auditor must follow the risk-based approach prescribed at §200.518, which includes consideration of the current and prior audit experience, oversight by Federal agencies and pass-through entities, and inherent risk of the Federal program. The SEFA is the basis for determining major programs to be tested. The standard 10110 audit program contains working papers to facilitate performing the risk-based assessment, which should be completed as part of the preliminary audit effort.

c. The risk-based approach is a four-step process:

(1) Using the SEFA, the auditor must first identify Federal programs as either Type A or Type B programs by establishing a dollar threshold using the parameters outlined in the Uniform Guidance:

§ 200.518 Criteria for determining Type A/B Threshold

Total Federal awards expended	Type A/B threshold
Equal to \$1,000,000 but less than or equal to \$34 million	\$1,000,000
Exceed \$34 million but less than or equal to \$100 million	Total Federal awards expended times .03
Exceed \$100 million but less than or equal to \$1 billion	\$3 million
Exceed \$1 billion but less than or equal to \$10 billion	Total Federal awards expended times .003
Exceed \$10 billion but less than equal to \$20 billion	\$30 million
Exceed \$20 billion	Total Federal awards expended times .0015

(a) During the initial coordination meeting, DCAA and the IPA should agree on the Type A/Type B threshold.

(b) Federal programs not labeled as Type A programs are Type B programs.

(c) The inclusion of large loan and loan guarantees should not result in exclusion of other programs as Type A programs. When a Federal program provides loans that exceed four times the largest non-loan program, it is considered a large loan program and must be excluded when determining other Type A programs. In other words, the Type A program threshold is calculated after removing all large loan programs. See §2 CFR 200.518(e) for additional requirements related to large loan programs and their impact on determining Type A programs.

(2) After determining the Type A programs, the auditor must then identify the low-risk Type A programs. In making this determination the auditor must consider the criteria for Federal Program risk (see 809), the results of audit follow-up, and the significance of any changes in personnel or systems affecting the program. In order to be considered low-risk, the Federal program must have been audited as a major program in at least one of the two most recent audit periods, and none of the following conditions exist:

- In the most recent audit period, no material weaknesses were reported in internal control,
- The opinion on compliance with the Federal program was not modified,

- Known or likely questioned costs did not exceed five percent of the total Federal awards expended for the program.

(3) After determining the low-risk Type A programs, the auditor must identify Type B programs that are high-risk using professional judgment and the criteria in §200.519 (criteria for Federal program risk). The auditor is NOT required to identify more high-risk Type B programs than at least one fourth of the number of low-risk Type A programs. Other than known material weakness in internal control or compliance problems, no single criteria in risk would generally cause a Type B program to be considered high-risk and professional judgment is required. Additionally, the auditor is not expected to perform risk assessments on relatively small Federal programs, which are defined as programs that are that do not exceed 25 percent of the Type A threshold. Therefore, if no Type A programs are identified as low-risk, the auditor does not need to assess risk for Type B programs.

(4) The last step in the process is to identify the major programs that will be tested during the annual audit. The auditor must audit all of the following as major programs (at a minimum):

- (a) All Type A programs not identified as low risk,
- (b) All Type B programs identified as high risk,
- (c) Additional programs as necessary to meet the percentage of coverage rule. This may require the auditor to audit more programs as major programs than the number of Type A programs. The percentage of coverage rule prescribes the following (§200.518(f)):
  - If the auditee is classified as a low-risk auditee (see [section 808](#)), the aggregate Federal programs audited as major programs must encompass at least 20 percent of the total Federal awards expended.
  - If the auditee is classified as other than a low-risk auditee, the programs tested as major programs must encompass at least 40 percent of the total Federal awards expended.
- d. The auditor must include in the working papers of the risk documentation of the analysis used to determine major programs.

### **13-811 Audit Documentation [\\*\\*](#)**

a. The Uniform Guidance audit must be completed in accordance with the requirements of GAGAS for financial audits (not attestation engagements), which incorporate the AU-C standards (not the AT-C) standards. Auditors should ensure they are documenting the appropriate criteria for standards when applicable. The audit team should review GAGAS for the standards for financial audits to determine if there are any additional requirements applicable to financial audits as compared to attestation engagements described in other chapters throughout CAM.

b. [Chapter 2](#) provides guidance on performing audits in accordance with GAGAS in order to state compliance with the standards in the audit report. Working papers should include sufficient detail to enable a third party reviewer, unfamiliar with the engagement, to determine that the audit was conducted in accordance with GAGAS, and that the findings are fully supported in the working papers.

c. [Chapter 3-204.14 and .15](#) provide guidance on obtaining and determining sufficiency of

evidence. Auditors should consider the audit objectives and the risk level in determining the sufficiency and appropriateness of evidence obtained and include documentation that fully supports the reported findings.

d. [Chapter 4-602.9](#) provides guidance on sampling plan design and documentation.

e. [Chapter 4-1000](#) provides guidance on using the work of other auditors. GAGAS 4.16 (2011 Yellow Book) states that audit organizations in Federal government and public accounting firms engaged to perform a financial audit in accordance with GAGAS cooperate in auditing programs of common interest so that auditors may use others' work and avoid duplication of efforts. If using the work of the IPA auditor, follow the guidance in 4-1000.

f. GAGAS requirements for reporting on internal control for financial audits are incorporated into the standard 10110 audit program and proforma report.

### **13-812 Summary Schedule of Prior Audit Findings [\\*\\*](#)**

a. The auditee must include a summary schedule of prior audit findings as part of the reporting package, which presents the status of corrective action on prior audit findings. The schedule must include all findings reported in the previous year's summary schedule except for findings listed as corrected or no longer valid in the previous summary schedule. Each audit finding must include a reference number in the form of YYYY-XXX (e.g. 2018-001) to permit entry into the FAC Data Collection Form, and to allow easy reference to the finding (13-816.1).

b. The auditor must design audit procedures to assess the accuracy and reasonableness of the summary schedule of prior audit findings prepared by the auditee (§200.514(e)). If the auditor determines that the status of corrective action materially misrepresented the actual status, the auditor must report this as a current year finding in the schedule of findings and questioned costs.

c. The summary schedule of prior audit findings and the auditee's corrective action plan should be included as appendices to the audit report.

### **13-813 Consideration of Fraud [\\*\\*](#)**

a. The auditor should review AU-C 240, GAGAS 4.06 – 4.09, and guidance throughout CAM related to the auditor's responsibilities to detect and report fraud. AU-C 240 requires auditors to plan and perform the examination considering fraud risk factors specific to the audit in order to obtain reasonable assurance that material misstatements or noncompliance are detected, whether caused by error or fraud. GAGAS requires auditors to extend the AICPA requirements to consideration of compliance with provisions of contracts or grants (GAGAS 4.06 – 4.09).

b. The auditor's risk assessment should be ongoing throughout the audit, following the initial assessment. Based on analytical procedures performed during the risk assessment, the auditor should evaluate whether unusual or unexpected relationships indicate risks of material misstatement due to fraud and determine the overall responses to address the assessed risks. When fraud or similar unlawful activity is suspected, the circumstances should be reported in accordance with [4-700](#).

### **13-814 Internal Control over Compliance with Federal Programs [\\*\\*](#)**

a. The auditee is required to establish and maintain effective internal control over Federal awards that provides reasonable assurance that the entity is managing the Federal awards in

compliance with Federal statutes, regulations, and the terms and conditions of the awards. The internal controls should reflect the principles in the “Standards for Internal Control in the Federal Government” issued by the Comptroller General of the United States and the “Internal Control Integrated Framework” issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). This means that the entity should incorporate the principles for the five components of internal control into its system of internal controls.

b. Auditors are required to perform procedures to obtain an understanding of internal control over Federal programs to determine whether the system of internal control provides reasonable assurance that the auditee is properly managing its Federal programs. In addition to the requirements of GAGAS, the auditor must perform procedures to obtain an understanding of control over Federal programs sufficient to plan the audit to support a low-assessed control risk for major programs (2 CFR 200.514(c)).

c. The auditor should review [AU-C 330](#), *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*, AU-C 240, *Consideration of Fraud in a Financial Statement Audit*, and the OMB compliance supplement guidance, Part 6, for guidance in designing procedures to test for effectiveness of internal controls over Federal programs. Tests of control must be performed in a manner that will provide evidence of the auditor’s assessment of control risk for each compliance requirement for each major program being tested.

d. The auditor should design and perform tests of internal control using the guidance in Part 9 of the AICPA Audit Guide, *Government Auditing Standards and Single Audits*, AU-C 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, AU-C 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*, AU-C 240, *Consideration of Fraud in a Financial Statement Audit*, and the OMB Compliance Supplement, Part 6. The Committee of Sponsoring Organizations of the Treadway Commission’s (COSO) Internal Control Framework provides discussion related to each of the five components including examples of controls that would be evident for each type of control.

### **13-814.1 Scope of Audit – Internal Control [\\*\\*](#)**

a. The Uniform Guidance requires auditors to obtain an understanding of the auditee’s internal control over Federal programs, to assess the control risk, to plan procedures for testing internal control, and to perform the tests as planned. An assessment of low control risk should generally result in lower sample sizes for compliance testing. Unlike most DCAA attestation audits, however, controls assessed at maximum risk for the Uniform Guidance financial or compliance audit, must be reported as a current year finding, which requires the auditor to develop the finding in accordance with GAGAS 4.10 through 4.14.

b. If the auditor plans to use evidence from a previous audit about the operating effectiveness of specific controls, the auditor should perform procedures to establish the continuing relevance of that information in the current audit. This can be obtained through inquiry, combined with observation and inspection (AU-C 330.14). In determining whether it is appropriate to use audit evidence about the operating effectiveness of controls obtained in previous audits, the auditor should consider the following (see AU-C 330.13):

- Length of time elapsed since testing the control,

- Effectiveness of other internal control elements, including the control environment, the entity's monitoring of controls, and the entity's risk assessment process,
- Risks arising from the characteristics of the control, such as whether the control is manual or automated and whether any changes have been made to the processes,
- Effectiveness of general IT controls,
- Effectiveness of the control and its application by the entity, including the nature and extent of deviations noted in previous audits and personnel changes that significantly affect the application of the control.

### **13-814.2 Testing and Assessing Risk of Internal Control \*\***

a. The Uniform Guidance does not require testing of internal control where the system of internal control is likely to be ineffective in preventing, or detecting and correcting, material noncompliances. This situation would always be considered significant. If the auditor limits the determination on internal control for any reason, the deficiencies/material weaknesses must be reported in the schedule of findings and questioned costs.

b. The auditor should gain sufficient understanding of the entity in order to identify key internal controls relevant to each compliance requirement subject to the audit and for each major program separately. Where key controls provide control for multiple compliance requirements and/or major programs, the auditor should document the impact of the effectiveness of the control for each compliance requirement, and for each major program.

c. The auditor should gain an understanding of controls for each of the five components of internal control identified in the COSO Internal Control Framework. The auditor should document the understanding for each component that is relevant to the applicable compliance requirements for which the auditor is testing compliance. The five components are:

(1) Control environment. This represents the “tone at the top” for the collective effect of management’s philosophy and operating style, the organizational structure, functioning of the board of directors, methods for assigning authority and responsibility, management’s methods for monitoring and following up on performance and identified deficiencies or noncompliances, attitude and response toward internal and external audit findings, implementation of formal policies and procedures that affect operations and practices. Key controls might include adequacy of relevant policies and procedures, clear designation of authorities and segregation of duties, procedures for addressing identified deficiencies, procedures to address misconduct or poor performance in employees, implementation of training plans for staff, etc.

(2) Risk Assessment. The risk assessment is the entity’s process for identifying areas that may have a significant negative impact on achieving their objectives. For example: how they identify where material misstatements, weaknesses, deficiencies may occur; how they assess environmental or economical changes might impact operations; how they consider the potential for fraud, how organization or system changes may significantly impact the system of internal control, etc.

(3) Control activities are typically deployed through policies that establish expectations, and the procedures that put the policies into action. The activities are designed to contribute to mitigating risks that may impede achieving objectives to an acceptable level. Control activities are the “day-to-day” procedures that help ensure material misstatements do not



occur without being detected. The activities can be manual or automated, and they may occur frequently or infrequently.

(4) Information and Communication. This is how the entity obtains, generates, and uses relevant, quality information to support the function of the other components of internal control. This component focuses on how the entity obtains and internally communicates information, including objectives and responsibilities for internal control, as well as how it communicates with external parties in matters that affect the functioning of internal control. Controls might include how employees are aware of program requirements and changes in requirements, how awarding agencies are notified of control or programmatic deficiencies or weaknesses, how the governing board is made aware of audit findings, etc.

(5) Monitoring Activities are activities that are ongoing (or established as separate evaluations, when needed) and designed to ascertain if the components of internal control are both present and functioning. Monitoring activities are also for evaluating and communicating internal control deficiencies in a timely manner to parties responsible for taking action. Monitoring controls might include: monthly reconciliations with reviews by responsible officials, comparison of budget to actual spending, review of funding levels to expenditures, reviews of program milestones to actual performance, evaluation of employee performance, etc.

d. During the audit, the auditor may become aware of deficiencies in the design, implementation, or operation of an internal control. Auditor judgment is required to determine if identified deficiencies are material weaknesses. AU-C 935.11 defines material weaknesses and deficiencies related to internal control, paraphrased as follows:

(1) A significant deficiency in internal control over compliance with a type of compliance requirement is a deficiency that is less severe than a material weakness but still important enough to merit attention of those charged with governance.

(2) A material weakness is a deficiency, or combination of deficiencies, such that there is a reasonable possibility that a material noncompliance will not be prevented, or detected and corrected, on a timely basis.

e. Professional judgment is required to determine whether a deficiency, or combination of deficiencies, is a significant deficiency or a material weakness. The severity of a deficiency depends on the magnitude of the potential noncompliance that may result. It is not necessary that a noncompliance actually happened for a material weakness to exist. Some factors to consider:

(1) the nature of the type of compliance requirement involved. For example, testing for compliance with a specific award provision may involve greater risk since it is unique to the program.

(2) program susceptibility to fraud,

(3) interaction or relationship of the control with other controls, or impact on other deficiencies,

(4) future consequences, if not corrected.

(5) program amounts and volume of transactions exposed to the deficiency,

(6) other qualitative factors.

f. The auditor should follow the guidance in 2-407 and GAGAS 4.03 – 4.04 for



communicating deficiencies. If the deficiency is determined to be a material weakness, it must be reported in the schedule of findings and questioned costs for the compliance audit. The auditor should coordinate with regional management and the auditee's independent public accounting firm prior to citing the auditee for a material weakness in internal control.

### **13-814.3 Dual-Purpose Testing \*\***

a. Dual-purpose testing is testing that is performed concurrently to assess both internal control effectiveness and compliance with Federal programs. In some circumstances, it may be more efficient to perform dual-purpose testing. For example, when a key control is not automated and requires selecting and testing a sample to determine the rate of deviation of the control, this could be done concurrently with tests for compliance with the cost principles. In situations where a key control is automated, it may be more efficient to test that control through observation or reperformance to assess its effectiveness. The nature, timing, and extent of testing for compliance with laws, regulations, and provisions of contracts and grants is generally dependent upon the results of testing internal control.

b. When using a dual-purpose sample to test for internal control effectiveness simultaneously with compliance testing, the auditor must determine and document that the sample universe is appropriate for both types of testing. The auditor must document the plan to use dual-purpose transaction testing when developing the sampling plan. Documentation must also clearly distinguish the audit procedures performed and their results for testing control and compliance separately.

c. If deficiencies in internal control are identified using dual-purpose testing, the auditor will need to determine, and document, whether additional testing for compliance is necessary to address the increased risk.

d. Because the purpose of testing internal control is very different from the purpose of testing for compliance, the sample selection, testing criteria, and results of testing must be documented, evaluated, and considered separately for internal control and compliance tests. In addition, the sample size selected for dual-purpose testing will be the larger of the two sample sizes determined for the internal control and compliance testing individually. The AICPA Audit Guide provides for minimum sample sizes for both tests of control and tests for compliance that should be considered.

### **13-814.4 Reporting – Internal Control \*\***

The report on internal control is typically included with the report on compliance. The auditor does not express an opinion on the overall system of internal control because procedures are not performed in order to express an opinion on the overall system. The internal control report will describe the scope of testing internal control and the results of testing. If deficiencies are reported, the internal control report will identify whether they are significant deficiencies or material weaknesses, and will provide the reference number assigned to it in the Schedule of Findings and Questioned Costs.

## **13-815 Audit for Compliance with Federal Programs \*\***

### **13-815.1 Introduction \*\***

a. 2 CFR 200 requires the auditor to express or disclaim an opinion on compliance for each major program. This section discusses the audit responsibilities for conducting the

compliance testing for the annual audit performed under the Uniform Guidance. The following sections cover:

- Audit Findings – Schedule of Findings and Questioned Costs ([section 816](#))
- Audit Reports – Compliance and Internal Control over Compliance ([section 817](#))
- Data Collection Form ([section 818](#))

#### **13-815.2 Scope of Audit \*\***

a. The auditor must consider the OMB compliance supplement (the Supplement) when designing procedures to test for compliance with Federal programs. The Supplement provides the objectives for each type of compliance requirement and contains suggested audit procedures for testing compliance. The Supplement also identifies the compliance requirements applicable to most Federal programs. See [section 806](#) for discussion related to the Supplement.

b. The auditor must determine whether the auditee complied with Federal statutes, regulations, and the terms and conditions of the Federal awards that may have a direct and material effect on each of its major programs (2 CFR 200.514). The principal compliance requirements applicable to most Federal programs are included in the Compliance Supplement. The DCAA audit team and the IPA will need to coordinate, prior to beginning the audit, in order to identify the compliance requirements that are material to Federal programs and designate which audit organization will be responsible for testing for compliance. If classified awards are involved, the auditor will also need to coordinate with Field Detachment. Documentation of the coordination activities should be maintained in the audit package.

c. The auditor should review the Federal programs to determine if the programs, or terms and conditions of the awards, contain restrictions that impact the 2 CFR 200 cost principles, or if there are applicable compliance requirements that are not included in the Supplement.

d. Compliance testing must include tests of transactions and such other auditing procedures necessary to provide the auditor with sufficient evidence to support an opinion on compliance with the Federal programs. Each Federal program identified as a major program needs to have testing performed that is specific to that program. DCAA is typically involved in the compliance audit only for the R&D major program. However, if more than one program is identified as a major program, the auditor should develop procedures for each major program independently.

e. The auditor must follow-up on prior audit findings to assess the reasonableness of the summary schedule of prior audit findings prepared by the auditee (see [section 811](#)).

#### **13-815.3 Selected Compliance Requirements \*\***

During the coordination efforts between DCAA and the IPA, the two organizations will agree which compliance requirements will be tested by which organization. Where the same audit procedures can be used to test for multiple compliance requirements, the auditor should plan to test them concurrently. See [Figure 13-8-1](#) for an example of the coordinated audit matrix. Typically DCAA performs audit procedures to test for compliance with the following compliance requirements:

(1) Compliance Requirement A, Allowable Activities. The auditor should review the Federal programs and design audit procedures to determine if unallowable costs resulting from

unallowable activities were charged to each major program tested.

(2) Compliance Requirement B, Allowable Cost/Cost Principles. The auditor should design audit procedures based on the results of tests of controls, and determine if costs expended were allowable for each major Federal program tested. See discussion in section 500 related to the CAS, the cost principles, and testing direct and indirect cost.

(3) Compliance Requirement H, Period of Performance. The auditor should design audit procedures to determine if costs were incurred within award periods of performance. The auditor should consider using analytical procedures during the risk assessment to determine if there is risk that needs to be addressed further due to funds that were incurred before or after the period of performance.

### **13-815.3.1 Subrecipient Monitoring \*\***

a. 2 CFR 200 does not apply to subrecipients that are for-profit organizations, ([§200.501\(h\)](#)) and the auditee must establish requirements to ensure compliance by for-profit subrecipients. The agreement between the auditee and the for-profit recipient should describe applicable compliance requirements and the subrecipient's compliance responsibility. Methods to ensure compliance may include pre-award audits, monitoring during the agreement, and post-award audits. The discussion that follows is applicable to nonprofit entities, including universities.

b. If the auditee makes awards to subrecipients, the auditee is required to perform monitoring and management of the subrecipient (§[200.330](#) - [.331](#)). A subrecipient is an entity that is responsible for carrying out a portion of the Federal program and is required to comply with Federal statutes, regulations, and the terms and conditions of the award. A vendor that only provides goods and services, such as materials, supplies or a payroll service, etc., for the awarding entity's own use is not a subrecipient.

c. A non-Federal entity may concurrently be a recipient (prime awardee), a subrecipient, and a vendor/contractor depending on the agreements with Federal agencies and other pass-through entities

d. The substance of a subaward prevails over the type of contracting vehicle used to issue the award. The auditor will need to evaluate significant subawards and determine if the auditee appropriately identified the subaward as a subrecipient or a vendor/contractor and whether the Subrecipient compliance requirement is applicable. Characteristics supporting the classification as a subrecipient are provided in 2 CFR 200.330.

e. All pass-through entities must ensure that every subaward clearly identifies the receiving entity as a subrecipient and includes the information specified in §200.331.

f. If the subawardee does not have Federally negotiated indirect cost rates, the pass-through entity must negotiate indirect cost rates with the subrecipient in compliance with the indirect cost rate requirements included in the applicable appendix of 2 CFR 200, depending on the type of entity receiving the award. The subrecipient may elect to use the 15 percent de minimis rate in lieu of negotiating rates.

g. The subrecipient must permit the pass-through entity and auditors, access to the subrecipient's records and financial information necessary to meet the requirements of the Uniform Guidance.

h. The subrecipient must have annual audits in accordance with 2 CFR 200, Subpart F.

i. The pass-through entity must monitor the activities of the subrecipient to ensure the subaward is used for authorized purposes and in compliance with Federal statutes, regulations, and terms and conditions of the subaward. This monitoring must include the following:

(1) Review of financial and programmatic reports required by the pass-through entity,

(2) Following-up and ensuring the subrecipient takes timely and appropriate action on all deficiencies detected through audits, on-site reviews or through other means when the deficiencies pertain to the Federal award.

### **13-815.3.2 Allowable Cost/Cost Principles \*\***

Generally, the most significant component of DCAA audit effort in the Compliance audit is focused on determining allowability of cost during testing for compliance requirement B, Allowable Cost/Cost Principles. Refer to [section 300](#) for discussion regarding the Uniform Guidance cost principles.

### **13-816 Schedule of Findings and Questioned Costs \*\***

a. This section provides guidance related to preparation of the findings identified in the audit. Audit findings are presented in the Schedule of Findings and Questioned Costs and should be presented in sufficient detail for the auditee to prepare a corrective action plan and for the cognizant agency for indirect rates to understand the significance of the finding to allow resolution of the finding. The Schedule is divided into three sections:

b. Section I – Summary of Auditor’s Results, which presents a summary of the audit opinion, whether there were material weaknesses or significant deficiencies in internal control over compliance, whether findings were required to be reported, identification of the Major programs, the dollar threshold for distinguishing between type A and type B programs, and whether the auditee is classified as a low-risk auditee. See [Figure 13-8-2](#) for an illustration of Section I.

c. Section II – Relates to the financial statements.

d. Section III – Findings related to Federal Awards presents the findings identified during the audit.

### **13-816.1 Elements of a Finding \*\***

a. Reference number - each audit finding must include a reference number in the form of YYYY-XXX (e.g. 2018-001) to permit entry into the FAC Data Collection Form, and to allow easy reference to the finding. The DCAA auditor and the IPA should agree during the initial coordination meeting how each audit organization will reference their findings. The elements of the findings must include the audit detail described below.

b. The elements of an audit finding will include (See the [Elements of a Finding Guidebook](#) for additional guidance):

(1) Condition found including the facts supporting the deficiency identified,

(2) Cause – a statement of cause that identifies the reason or explanation for the condition or the factors responsible for the difference between the condition identified and the

criteria,

(3) Criteria – the specific regulatory, statutory, or other criteria, such as the specific terms and conditions of the award that were not complied with. Provide enough information to provide proper perspective for the significance and potential consequences of the deficiency. Where appropriate, include the number of instances of noncompliance, the size of the universe, and the sample size examined,

(4) Effect – the possible asserted effect of the deficiency in sufficient detail to provide the auditee and Federal agency, or pass through entity, to determine the cause and effect of the deficiency and to facilitate prompt and proper corrective action. The statement should provide a clear and logical link to establish the impact or potential impact of the deficiency between the condition and criteria.

(5) Recommendation – what needs to be done to prevent future occurrences of the deficiency – this should be related to the criteria requirements – not a specific management action.

c. Obtain and include the views of responsible officials of the audited entity, which can be included as an appendix and referenced in the audit finding. When summarizing the entity's response, be mindful that the report will publicly available.

d. The auditor's response to the views of the responsible officials should include comments on whether and/or how the auditee's perspective impacted the audit finding.

### **13-816.2 Audit Findings \*\***

a. Audit findings must be presented in sufficient detail and clarity for the auditee to prepare a corrective action plan and take corrective action, and to enable Federal agencies and pass-through entities to make a management decision (2 CFR 200.516(b))

b. Findings must include the Federal program and specific CFDA title and number, Federal award identification number and year, name of the Federal agency (or pass-through entity). When CFDA information is not available, use the best information available to describe the Federal award. If auditing a cluster (such as the R&D cluster), the auditor may reference back to the SEFA R&D Cluster information rather than repeating the award information.

c. Each finding should state definitively whether or not the finding is a repeat finding. Meaning, if a finding was not a repeat finding, the auditor must state that the finding is not a repeat finding, and if the finding is a repeat finding, must state that the finding is a repeat finding.

d. The Schedule of Findings and Questioned Cost must include findings related to the following deficiencies identified (2 CFR 200.516).

(1) Questioned costs that are known to be, or are likely to be, greater than \$25,000 for a compliance requirement for a major program. When reporting questioned cost, the auditor must include sufficient information to provide proper perspective for judging the prevalence and consequences of the questioned costs and include how the questioned costs were computed. Known questioned costs must be identified by applicable CFDA number and applicable Federal award identification number.

(2) Significant deficiencies and material weaknesses in internal control over major

programs and significant instances of abuse relating to major programs. The determination of whether the deficiency is a significant deficiency or a material weakness should be made in consideration of the type of compliance requirement for the major program.

(3) Instances where the results of audit follow-up procedures disclosed that the summary schedule of prior audit findings materially misrepresents the status of a prior audit finding. When this occurs, the current year finding should use the current year referencing scheme, and reference the prior finding using the reference number applicable in the prior year's report.

e. The following must be reported as a finding unless they are already included in another finding:

(1) Circumstances why the report on compliance is other than an unmodified opinion,

(2) Known or likely fraud affecting a Federal award. See CAM 4-700 for guidance in reporting fraud, which could compromise investigative or legal proceedings.

### **13-817 Audit Reports \*\***

a. DCAA's Uniform Guidance audit report includes a report on internal control over compliance with Federal programs, and a report with an opinion on compliance with laws, regulations, and terms and conditions of an award. The reports can be issued separately, but are generally submitted as a combined document.

b. A separate opinion (or disclaimer of opinion) must be reported for compliance with each Federal program audited. Therefore, when more than one Federal program or cluster is audited, the report may contain different opinions. Depending on the coordination between the IPA and DCAA, both the IPA and DCAA will report on compliance and internal control over compliance in their respective reports.

c. The Report on Compliance for Each Major Federal Program should identify the compliance requirements identified as direct and material to the Federal program, a statement of management's responsibility, a statement of auditor's responsibility, the opinion on compliance for the Federal program, and other matters, as applicable.

d. The report on internal control over compliance must define the scope of testing of internal control over compliance, define "deficiency", "material weakness", and "significant deficiency". No opinion is provided for the report on internal control but must reference the Schedule of Findings and Questioned Costs and identify whether each finding (by reference number) is a significant deficiency or material weakness.

e. A report section, generally following the report on internal control over compliance, should provide auditor comments on the Summary Schedule of Prior Audit Findings with a description of results of testing the prior audit findings and references to any current findings related to the Summary Schedule.

f. The IPA performing the financial statement audit will report on whether the schedule of expenditures of Federal awards is fairly stated in relation to the financial statements.

#### **13-817.1 Scope Limitations \*\***

Situations may arise that cause a limitation on the scope of the Uniform Guidance compliance audit, which may result in the need to issue a qualified audit opinion or disclaimer of



opinion, depending on the significance of the limitation. A scope limitation might arise, for example, when:

(1) A significant portion of the Federal awards are from non-DoD agencies that are unwilling to reimburse DCAA for audit services. The Uniform Guidance requires that the entity's entire operations be covered by the single audit. When a non-DoD agency will not reimburse DCAA for audit services, and the IPA is willing to provide the required audit coverage for those awards, additional coordination would be required to ensure DCAA can appropriately rely on the IPA's audit results. For example, the IPA may agree to perform audit procedures designed by DCAA for the compliance requirement and allow DCAA to assess the reliability of the IPA's audit effort through direct supervision or DCAA supervisory review of the working papers, and incorporate the results into the overall determination of compliance for that requirement. If the IPA is unable, or unwilling, to provide the necessary coverage, the FAO should leave the non-DoD awards in the audit universe, and report findings as required by CFDA in the schedule of findings and questioned costs, but will not provide additional analysis or details to the non-DoD agency.

(2) A significant portion of the expenditures for the period is excluded from the scope of DCAA's audit due to restricted access to information, including classified information, or individuals, or when assist audit reports have not been received.

(3) The work performed by other Government audit organizations is material to DCAA's opinion, and the auditor is unable to rely on the work performed. The audit report will exclude the associated awards, and the scope limitation should not indicate the level of classification of any such awards.

### **13-817.2 Report Restrictive Markings \*\***

a. The auditor with the appropriate authority must issue DCAA's Uniform Guidance audit reports in Portable Document Format (PDF) with digitally secured signatures to protect the integrity of the audit report.

b. The Uniform Guidance report will include the "CUI" markings to comply with applicable law, regulations, and Government-wide policies for Controlled Unclassified Information . The "restrictions" language defines the "CUI" marking as a document designation, not a classification, and authorizes the auditee to release the audit report to the public at its direction.

c. Audit report restrictions include language that the audit report is a restricted-use report, and should not be used by anyone other than the intended parties specified in the audit report. The Audit Report Distribution and Restrictions page includes language to comply with Statement on Auditing Standards AU-C 905, Alert That Restricts the Use of the Auditor's Written Communication. A restricted-use report is one that is intended only for specified parties.

### **13-817.3 Report Distribution \*\***

a. The cognizant FAO will prepare the final audit reports on (i) compliance with Federal programs and (ii) on internal control over compliance. The Uniform Guidance permits the compliance and internal control reports to be submitted in the form of either combined or separate reports. Each report must state that the audit was conducted in accordance with 2 CFR 200, Subpart F (§200.515). Where other DCAA offices, including Field Detachment, performed audit procedures to support the audit, the cognizant FAO will incorporate those results into the final report and schedule of findings and questioned costs.

b. The auditee submits its complete audit report package to a federal clearinghouse designated by OMB. The final reports are publicly available.

### **13-818 Auditor Responsibility for the Data Collection Form \*\***

The auditee must complete and submit the Data Collection Form (DCF) required by the Federal Audit Clearinghouse (FAC) when it submits its annual single audit reporting package. The DCF contains several components, some the auditee will complete, and some sections the auditor completes. The audit entity that assumes responsibility for completing the DCF will complete the auditor portions of the DCF for both the DCAA FAO and the IPA. This responsibility should be discussed and agreed-to during the initial coordination meeting. If the IPA completes the DCF, the FAO should review the DCF prior to submission to the FAC to ensure DCAA information and findings are appropriately included in the DCF.

### **13-819 Program Specific Audits \*\***

a. Under certain circumstances, an auditee may elect to have a program-specific audit performed instead of the annual single audit (§200.501(c)). A program specific audit may be performed only when Federal expenditures for the year are under a single Federal program, and the Federal award does not require the auditee to have an annual financial statement audit performed. The Federal agency or pass-through entity must approve the performance of a program-specific audit in advance.

b. A program-specific audit may not be elected for the R&D program cluster unless all of the Federal awards expended were from the same Federal agency (or from the same Federal agency and the same pass-through entity if performing as a subrecipient). Typically, the R&D cluster is comprised of awards from multiple agencies.

c. If engaged to perform a program-specific audit, the auditor must first determine if a program-specific audit can be performed given the criteria in 2 CFR 200.507, and contact the Office of Inspector General of the Federal agency to obtain a program-specific audit guide. A program-specific audit guide provides specific guidance with respect to internal controls, compliance requirements, suggested audit procedures, and audit reporting requirements. If a program-specific audit is performed, the engagement should be completed using the 10110 standard audit program with modifications as necessary.

d. Because DCAA does not typically perform program-specific audits, the auditor is referred to §200.507 for guidance and should coordinate with RST and/or headquarters as necessary to perform the audit.

Figure 13-8-1 Coordinated Audit Matrix Example [\\*\\*](#)

<b>AUDIT COORDINATION MATRIX</b>						
			<b>Org Responsible for Audit Coverage and Reporting</b>			
<b>Major Program Compliance Requirements (See Compliance Supplement, Parts 2&amp;3)</b>	<b>Applicable (Y or N/A)</b>	<b>Material Effect on Major Program (Y or N)</b>	<b>IPA</b>	<b>DCAA FAO</b>	<b>DCAA FD<sup>3</sup></b>	<b>Comments<sup>4</sup></b>
A - Activities Allowed or Unallowed						
B - Allowable Costs/Cost Principles						
C - Cash Management						
D - Reserved						
E - Eligibility						
F - Equipment and Real Property Management						
G - Matching, Level of Effort, Earmarking						
H - Period of Performance						
I - Procurement and Suspension and Debarment						
J - Program Income						
K - Reserved						
L - Reporting						
M - Subrecipient Monitoring						
N - Special Tests & Provisions						
Opinion on Schedule of Expenditures of Federal Awards						
Completion of Data Collection Form						
Other (list as applicable						

Figure 13-8-2 Section I of the Schedule of Findings and Questioned Costs **\*\***

<b>Audit Report No.</b>	<b>EXHIBIT</b>
<b>SCHEDULE OF FINDINGS AND QUESTIONED COSTS</b> <i>Auditee Name</i> <b>Fiscal Year Ended XXXX</b>	
<b>SECTION I: -- SUMMARY OF AUDITOR'S RESULTS:</b>	
<b>A. Financial Statements:</b>	
Information pertaining to the financial statements and the report on the Schedule of Expenditures of Federal Awards required by the Uniform Guidance are included in the independent public accountant's audit report.	
<b>B. Federal Awards:</b>	
Type of auditor's report issued on compliance for major programs:	
Type of Audit Opinion	Identify the Major Federal Program/Cluster Name as necessary corresponding to the opinion
Unmodified	
Qualified	
Adverse	
Disclaimer	
Internal control over major programs:	
	Yes      None Reported
Material weaknesses were identified.	
Significant deficiencies identified not considered to be material weaknesses.	
Audit findings disclosed that are required to be reported in accordance with 2 CFR 200.516(a)	
Yes	
No	
Identification of Major Programs:	
CFDA Number	Federal Program
Dollar threshold used to distinguish between Type A and Type B programs:	
Auditee classified as a low-risk under 2 CFR 200 Subpart F:	
Yes	
No	

## 13-900 Federally Funded Research and Development Centers (FFRDCs) and University Affiliated Research Centers (UARCs) **\*\***

### 13-901 Introduction**\*\***

This section provides basic information for FFRDCs and UARCs, applicable regulations, and guidance as to the auditor's responsibilities related to the audit of FFRDC fees. For activities related to performing the Uniform Guidance audit as part of the annual single audit prescribed under 2 CFR 200, Subpart F, see section 13-800, but note that the auditor will need to determine if an FFRDC is exempt from the 2 CFR 200, Subpart E cost principles.

### 13-902 FFRDC Organizations**\*\***

- a. An FFRDC sponsored by the DoD is an independent, private-sector, nonprofit

organizational unit possessing the capabilities to meet strategic long-term engineering, research, development, or other analytical needs that cannot be met as effectively by Government or other private-sector resources ([DoDI 5000.77](#)). FFRDCs perform activities sponsored under a broad charter by Government agencies and receive 70 percent or more of the financial support from the Government.

b. Most or all of the FFRDC facilities are owned or funded by the Government but are operated by commercial, nonprofit, or IHEs. The FFRDC operates as either an autonomous organization, or as a separately identifiable operating unit of the parent organization. DoD-sponsored FFRDCs are operated by either an IHE or a nonprofit organization under long term contracts, generally with 5-year periods of performance.

c. The FFRDC has access to Government and supplier data, employees, and facilities beyond that of the common/normal contractual relationship.

d. The National Science Foundation (NSF) maintains a [master listing](#) of FFRDCs and sponsoring Federal agencies.

### **13-903 Federal and DoD Laws and Regulations Applicable to FFRDCs [\\*\\*](#)**

a. [FAR 6.302-3](#) implements [10 U.S.C. 3204\(a\)\(3\)\(B\)](#) and permits FFRDCs exemption from the Competition in Contracting Act, allowing FFRDCs to issue sole-source contracts for specified needs.

b. [FAR 35.017](#) prescribes Government-wide policies for the establishment, use, oversight, and termination of an FFRDC.

c. The [DoD Instruction 5000.77](#) establishes the FFRDC Management Plan issued by the Director, Defense Research and Engineering, and sets forth the Department's policies and procedures for the management and use of DoD-sponsored FFRDCs.

d. [DFARS 215.404-75](#), provides guidance to the contracting officer to determine whether payment of management fees to an FFRDC operated by a nonprofit organization is appropriate.

e. The 2018 NDAA (Public Law 115-124)

(1) §8025(c) continues a long-standing prohibition on FFRDCs use of DoD funds to construct new buildings that are not on a military installation. "Notwithstanding any other provision of law, none of the funds available to the department from any source during the current fiscal year may be used by a defense FFRDC, through a fee or other payment mechanism for construction of new buildings not located on a military installation, for payment of cost sharing for projects funded by Government grants, for absorption of contract overruns, or for certain charitable contributions, not to include employee participation in community service and/or development".

(2) §8025(b) prohibits certain individuals from being compensated for his or her services as a member of the entity, or as a paid consultant by more than one FFRDC in a fiscal year. However, travel expenses and per diem as authorized under the Federal Joint Travel Regulations are allowable for the individual when engaged in the performance of membership duties.

### **13-904 FFRDC Audit Activities [\\*\\*](#)**

a. The 2 CFR 200, Subpart F audit requirements for an annual single audit are applicable to IHEs or nonprofit organizations operating an FFRDC. The FFRDC may have an annual single

audit performed separately from its parent organization.

b. Costs incurred by the FFRDC are generally subject to the cost principles applicable to the type of entity operating the FFRDC. However, some FFRDCs are exempt from the requirements of 2 CFR 200 cost principles. See 2 CFR 200, [Appendix VIII](#) for a list of organizations that are exempt from the 2 CFR 200. Additional organizations can be granted a waiver for exemption on a case-by-case basis from the OMB. An organization that is exempt from the 2 CFR 200, Subpart E cost principles, is subject to the FAR Part 31 cost principles. The auditor must ensure to use the appropriate cost principles when performing audits at an FFRDC.

c. When the FFRDC is exempt from the 2 CFR 200, Subpart E cost principles, the remaining portions of 2 CFR 200 are still applicable to the organization. However, the FFRDC may forego competition in procurement required by 2 CFR 200 Procurement Standards (2 CFR [200.317 - .326](#)) for some circumstances (see [FAR 6.302-3](#)).

d. All FFRDCs, including those operated by IHEs, are subject to the CASB rules and regulations in 48 CFR [9903.101 to 9903.307](#), and to the cost accounting standards in 48 CFR [9904](#).

### **13-904.1 FFRDC Fees \*\***

a. Nonprofit organizations and IHEs do not generally receive fees in addition to reimbursement of incurred cost. However, for an FFRDC, the contracting officer may determine that payment of management fees are appropriate to provide for additional funding in addition to reimbursement of incurred costs. See DFARS [215.404-75](#) for additional information.

b. DoDI 5000-77, Section 9, provides DoD instruction for determining the need for FFRDC fees. To arrive at a fee amount, the contracting officer may seek DCAA's assistance. Although DCAA is not responsible for fee determination, the auditor may be requested to comment on whether the FFRDC's financial and cost data supporting the fee proposal are fairly stated. These efforts should be performed under an agreed-upon procedures engagement, or as an advisory service and the auditor's comments regarding fee will not include an audit opinion and the auditor's effort will be limited to providing only factual information.

c. The proposal for fee justification must provide sufficient visibility into each element of fee to identify its purpose, and comply with fee reimbursement restrictions and limitations in accordance with applicable statutes and regulations. The proposal must identify, for inclusion as an element of fee, costs not allowable under the contract that the parent organization can demonstrate are ordinary and necessary for its successful operation.

d. The use of weighted guidelines or an alternate structured approach to establish FFRDC fees is prohibited by DFARS 215.404-75(c).

### **13-905 UARC Organizations \*\***

a. A University Affiliated Research Center (UARC) is a strategic United States Department of Defense (DoD) research program that is associated with a university. It is a research organization within an IHE. College and University laboratories that receive sole source funds, on average, exceeding \$6 million annually under authority of [10 U.S.C. 3204\(a\)\(3\)\(B\)](#). The authority of this US Code allows the awarding of sole-source contracts to establish or maintain an essential engineering, research, or development capability to be provided by an educational institute or other nonprofit institute or a federally funded research and development center. These



awards are designated UARCs by the Director, Defense Research and Engineering (DDR&E). UARCs have a university affiliation and a primary sponsor.

b. UARCs are university-led collaborations between universities, industry and defense laboratories that conduct:

- Basic Research,
- Applied Research,
- Advance Technology Development,
- Demonstration and Validation,
- Systems Development and Demonstration,
- Research Development Test and Evaluation (RDT&E) Management Support, and
- Operational System Development.

The universities provide dedicated facilities and share space with government and industrial participants. Although UARCs receive sole source funding under the authority of 10 U.S.C. Section 3204(a)(3)(B), they may also compete for science and technology work unless precluded from doing so by their DoD UARC contracts. Additionally, UARCs may not compete against industry in response to competitive Request for Proposals (RFPs) for development or production that involve engineering expertise developed or sustained through contracts awarded under 10 U.S.C. 3204(a)(3)(B).

c. UARCs have access to Government and supplier data, employees, and facilities beyond that of the common/normal contractual relationship. The UARC is required to operate in the public interest and conduct its business in a manner befitting its special relationship with the Government.

d. The DoD's Defense Innovation Marketplace maintains a [master listing](#) of DoD FFRDCs and all UARCs.

### **13-906 Federal and DoD Laws and Regulations Applicable to UARCs \*\***

a. [FAR 6.302-3](#) implements [10 U.S.C. 3204\(a\)\(3\)](#) which allows agencies to use procedures other than full and open competition. UARCs are defined as organizations which meet the criteria of 10 U.S.C. 3204(a)(3)(B).

b. UARCs are defined, and policies and procedures established, under the [Department of Defense University Affiliated Research Center Management Plan](#).

c. UARCs are components of IHEs, and therefore, subject to the requirements of 2 CFR 200.

### **13-907 UARC Audit Activities \*\***

UARCs are organizations within IHEs, and accordingly, are subject to the same IHE regulatory coverage codified within 2 CFR 200. Unlike FFRDCs, there are no specific NDAA restrictions on expenditures. UARCs may arrange to have services provided by a nonprofit or FFRDC. The costs for such services are subject to the regulations that apply to the service provider.