# Financial Management for Non-Profits: A Primer

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Introduction

The purpose of this Primer is to help small nonprofit organizations understand the importance of good financial management and all that this entails. This means understanding: (1) the financial responsibilities of the management of the organization; (2) the budgeting process; (3) the accounting system; (4) what internal controls mean; (5) how to report; and (6) how to manage federal funds.

Non-profit (tax-exempt) status bestows (potentially) numerous financially lucrative privileges and benefits on an organization. For this reason, nonprofit organizations must scrupulously manage their fiscal resources. Nonprofits must maintain accurate records and have these records reviewed periodically by an independent outside examiner who can certify that the organization is operating legally and according to generally accepted accounting procedures.

This Primer is a compilation of information found in books, manuals, and other printed materials, some of which is available via the World Wide Web. Some of this information has been updated and/or adapted to meet the particular needs of its intended audience, namely, small Nebraska non-profit organizations that carry out housing and community development activities. It should be pointed out that these are but a few of the resources available. There is truly an immense amount of material available to assist nonprofit organizations in financial management and other matters of operation. The information in this Primer comes from, or is based on information from, the following sources, listed alphabetically:


Alliance for Nonprofit Management. Alliance Resource Center and FAQs. [on-line]


Lyndee Black, Partner and CPA, Thomas, Kunc & Black, LLP, Certified Public Accountants. Lincoln, Nebraska.


Financial Accounting Standards Board. [on-line].

Foundation Center. [on-line].


Hummel, Joan M. Starting and Running a Nonprofit Organization. 2nd Ed. Revised by the Center for Nonprofit Management, Univ. of St. Thomas. Minneapolis: University of Minnesota Press, 1996.

Internal Revenue Service. Forms and Instructions. [on-line].


Management Assistance Program for Nonprofits. Free Management Library. [on-line]


Office of Management and Budget. OMB Circulars A-110, 122, and 133.


NOTE: On-line information can be accessed via a websearch for a particular reference.
This Primer is organized into seven parts:

**Part I:** describes the responsibilities of board members and staff (executive director), as well as discusses the importance of obtaining expertise for the accounting and financial management functions of an organization, and the importance of computers in the day-to-day and overall operations of an organization.

**Part II:** identifies one way that budgeting can be carried out in a nonprofit organization. What it is, who does it, its interdependence with program planning, and how it fits into the annual fiscal cycle. This part details the steps, tasks, and procedures associated with planning, estimating, developing, and submitting a complete, fully documented budget, and using the budget as an assessment tool throughout the year.

**Part III:** introduces the reader to the major three financial statements that should be produced by all non-profit organizations and describes the accounting system necessary to produce these results in an accurate and timely way. This part describes recommended accounting systems and describes accrual-based accounting, the functional classification of expenses, types of accounts in a system, and dual entry accounting.

**Part IV:** emphasizes the importance of internal controls and details many types and methods of internal control needed to safeguard an organization’s assets.

**Part V:** describes financial audits, what responsibilities a non-profit organization has in the auditing process, and the meaning of an auditor’s report and opinion. This part also details the state and federal reporting requirements of non-profit organizations, including income and payroll tax reporting requirements, IRS Form 990, and others.

**Part VI:** details the various federal requirements that must be followed by organizations that receive federal funding. Areas covered in this part include uniform administrative requirements, cost principles, and audits as set forth in OMB Circulars A-110, A-122, and A-133, respectively.

**Part VII:** suggests ways to build the strength of your organization through strategic planning, securing investors and developing partnerships. In this part, emphasis is on strong financial management is an organization’s best marketing tool.

The Appendices included in this Primer consist of a Sample Policies and Procedures Manual developed by the Local Initiatives Support Corporation (Appendix A), and the most recent, complete revisions of applicable OMB Circulars and HUD regulations (Appendices B through E).
Part I: Starting on the Right Track

The information contained in this part comes from a variety of sources, including the Management Assistance Group (from “Steering Nonprofits”), Starting and Running a Nonprofit Organization by Joan Hummel, Managing the Nonprofit Organization: Practices and Principles by Peter Drucker, Managing a Nonprofit Organization by Thomas Wolf, and on-line information from the Alliance for Nonprofit Management.

The foundation for an effective system of financial management for any nonprofit lies with the people that guide and assist the organization. These people, their leadership and commitment, and their roles within the operations of an organization are critical to its continuing existence. After all, without people carrying out their respective obligations and duties there would be no organization to manage! Most important to an organization is its Board of Directors and its Executive Director. However, an organization must often go “outside” to find expertise that the board or the staff does not possess. It is with this in mind that the following discussion occurs.

The Serious Business of the Board of Directors

The law carves out very specific roles for the board of directors in connection with the governance of a legally constituted nonprofit organization. Nonprofit organizations are granted several very lucrative concessions and immunities by the federal and state government, especially after they have received permission to operate as a tax-exempt corporation. Once an organization is declared tax-exempt, several governmental authorities at the federal, state, and in some cases, the local level give up their right to tax. Furthermore, the IRS generally agrees to allow individuals and institutional donors to claim tax deductions when they make gifts to these organizations. This is no less than a generous public subsidy. In making this concession, the government assumes that the organization is, in some way, serving the public and not operating for anyone’s private financial gain. It is in the name of public interest that the organization seeks and is granted its tax-exempt status.

For this reason, there needs to be some protection built into the system so that the government can be assured that the public purposes of non-profit organizations are in fact being carried out. It requires that a group of people act as guardians of the public trust... individuals who have the public’s interest at heart. These people are the board of directors, often called the trustees. It is a trustees task to act as stewards, accountable to the state government that granted the organization its charter, accountable to the federal government that granted tax-exempt status, and ultimately accountable to the public itself.

Board members represent the interests and needs of the public at large as well as those of the particular constituency the organization is pledged to serve. While the staff may not be unaware of the general public’s interest, board members are selected because, among other
things, they hold positions in the community that represent the broad array of public interests affected by the organization’s activity. In order to ensure that the trustees of nonprofit organizations have the public’s interest at heart, they are expected to serve without compensation (except for reasonable reimbursement for out-of-pocket expenses), as volunteers, for the public good, and to exercise, on behalf of the public, a legal and fiduciary responsibility. Because of this fiduciary responsibility, the board of a nonprofit is answerable to the government agencies that regulate and monitor nonprofit corporations. The Board of Directors represents the stable, continuing element of an organization. Staffs are transient, with people leaving to other organizations and employment. A board is enduring and, as such, controls the organization’s future.

Throughout an organization’s existence and evolution, the roles of board members may change. For instance, early in an organization’s existence, a board is most likely (and hopefully) a “working” board, with one or more board members involved in some of the day-to-day activities needed to operate the organization. (This working role will be discussed in more detail in Part IV. Internal Controls.) As an organization matures, however, the role may become one of purely governance. But what are the responsibilities of the board of directors? In general, the Board of Directors assumes specific responsibilities in the following areas:

**Legal Responsibilities**

By law, the board is responsible for determining the organization’s mission and setting policies for its operation. In doing this, it must also ensure that the provisions of the organization’s charter and the law are being followed. This begins with drafting (and amending when necessary) two documents that set out various rules, regulations, and procedures. These are the Articles of Incorporation and the bylaws.

Because so much of the organization’s character and reason for being are contained in the articles of incorporation, the board should review it at least once every three years. Changes should be stated as amendments, approved by the board, and subsequently filed with the state. Part of the legal obligation of the Board is to make sure that the corporation is carrying out its activities and fulfilling its mission as specified in the Articles.

Bylaws serve as the organization’s operating constitution. Bylaws go beyond the general material contained in the charter and discuss more detailed and specific procedures affecting the trustees themselves. For example, the bylaws set out the number, tenure, and election procedures for board members, discuss how and when meetings are called, how officers (president, treasurer, secretary and so on) are elected and what their powers are, how votes are taken, how board vacancies are filled, and host of other small details essential to the smooth operation of the organization. Bylaws, like articles of organization, must be reviewed periodically and updated. Furthermore, it is the responsibility of the trustees to see that the provisions are followed in order to avoid legal complications.
One example of the board’s legal responsibilities in this capacity is where a nonprofit organization seeks recognition and certification as a Community Housing Development Organization (CHDO). To obtain CHDO designation, HOME regulations require that nonprofit organizations meet certain requirements:

- The CHDO must be organized as a nonprofit organization under state law. (This initially requires filing articles of incorporation and bylaws with the State.) HOME regulations further state that the provision of decent housing that is affordable to low- and moderate-income persons must be among the purposes of the organization, and that this commitment must be evidenced in the CHDO’s charter, articles of incorporation, by-laws, or a resolution of the CHDO’s board of directors. In addition to these requirements, an organization must have received a tax-exempt ruling from the IRS under Section 501(c) of the Internal Revenue Code of 1986.

- CHDO’s should also have a clearly defined geographic service area, which may be a neighborhood, an entire community (that is, a city, town, village,) or a larger area (county or multi-county area), but not the whole states. This can also be spelled out within the organization’s charter (mission statement).

- A CHDO’s board must have representation from the groups it is serving. For this, the organization’s bylaws must spell out that low- and moderate-income populations must have at least one-third representation on the board. This representation can be achieved in several ways:
  1. Board members can be residents of low-income neighborhoods in the community. Importantly, residents of low-income neighborhoods on CHDO boards do not have to be low-income themselves. AND/OR
  2. Board members can be low-income residents of the community. This means that the board member has an annual income that does not exceed 80% of the area median income. AND/OR
  3. Board members can be elected representatives of low-income neighborhood organizations. These are organizations with the primary purpose of serving the interest of the neighborhood residents.

HOME regulations also state that no more than one-third of the board members may be representatives of the public sector. These are elected or appointed public officials, public employees, or persons appointed by a public official to serve on the board. Importantly, even if a public official meets the test of representing the low-income community (see above), they cannot be counted toward the one-third minimum requirement of low-income community representatives. The balance of the board is unrestricted, and may include people such as human and social service providers, lenders, individuals with access to philanthropic resources, or others willing to contribute their professional expertise.
In addition to amending the charter and bylaws as may be required, the board must also establish a formal process for involving low-income program beneficiaries in decisions related to the organization’s HOME-funded housing activities.

Beyond the Charter and the Bylaws, the board should also develop a board manual to further clarify roles, responsibilities, duties, and general policies. The Board manual provides a detailed account of the roles and responsibilities of trustees. Of critical importance, whether contained within this manual or a separate document, is a formal policy on conflicts-of-interest by board members. This policy should suggest:

1. That an individual with a conflict fully disclose his or her relationship to the individual or organization benefiting from the decision.

2. That the individual with a conflict not participate in the decision in which the conflict exists, which might mean not participating in the vote, not entering into the discussion prior to the vote, or absenting himself or herself from the room during the discussion and the vote.

**Financial Management**

The Board holds the ultimate accountability for the responsible and prudent use of the nonprofit organization’s money and other assets. A key role of board members in the financial management of an organization is the development and monitoring of the budget. The annual budget should be prepared with the involvement of board members (a finance committee can be established) and board members must satisfy themselves that revenues will be adequate to meet projected expenses. In reviewing the budget, individual board members should make sure that they understand major budget items. The board should also understand the basis of income estimates and pay particular attention to any fund-raising obligations they themselves are assuming. Serious errors in the budget’s plans for income and expenses can prove devastating to an organization. The board (who may place a committee or one board member, such as the treasurer, in charge of this) has the following responsibilities in the budgeting process:

- Ensuring that the budget is prepared and presented in a timely fashion;
- Reviewing the budget (generally prepared by staff) to determine that:
  - Budget assumptions are realistic in light of market conditions (i.e., are salaries in line with others in the area);
  - Specific types of revenue and/or expenses will not jeopardize the organization’s tax-exempt status;
  - Cash management to account for the “ebb and flow” of funds has been addressed;
Contributions with permanent, temporary, and without donor-imposed restrictions are properly accounted for within the budget;

Indirect costs associated with supporting activities are justifiable in light of total program expenses;

The Budget has sufficient detail to allow for comparison with actual results during the year; and,

Projected program expenses as a percentage of total revenues are reasonable.

Budget preparation and review is only part of this oversight responsibility. Board members must approve the budget before the budget period begins, an official action on the part of the Board that carries the force of an endorsement and certain other responsibilities (such as a commitment to fund raising if there are projected revenues based on fund raising). And Board members must monitor and, if necessary, amend the budget throughout the year. This monitoring is based on interim financial statements reviewed at board meetings that show how the actual revenue and expense figures compare with what has been budgeted. So, when the board approves a program and budget for the year, it should also specify appropriate times for reports on performance, income and costs. This monitoring the budget establishes a certain amount of financial controls. Financial policy development, however, is also necessary.

Financial policy development is another way the board meets its responsibilities for the financial management of an organization. In this the board takes an active role in reviewing and/or determining and approving fiscal policies and internal control practices. Generally, the board reviews and approves organizational operating policies (often developed with the assistance of various board committees) that the staff proposes. These policies are the rules or guidelines that provide the framework for the staff’s decision making and actions (for example, “All checks larger than $500 must be signed by two people.”) Other fiscal policies include such things as:

- Who will approve invoices and sign checks?
- Will individual staff members responsible for finances be bonded? Will the treasurer be bonded?
- Will there be a petty cash account and what controls will be put on its use?
- Should the organization allow first person checks that are not countersigned?
- Should the books be audited by an outside examiner? If so, a group of board members must assist in the selection of this individual, review his or her report, and address any deficiencies that are revealed by the examination (or audit) itself.

Note: In new or small nonprofits, boards should go beyond policy review and approval and insist on establishing procedures that spell out what steps must be taken and who must be
included in certain internal processes. In larger organizations, such procedures are generally formulated by the staff and only reviewed by the appropriate board committees.

The third area of a board's involvement in financial management is in the area of audits. Most organizations are required by their by-laws or by funding sources to have an annual financial audit or review performed by an independent accounting firm. (Also see Part V. Audits and Reporting.) In this area, the board should be active in reviewing the qualifications of and proposals from accountants or accounting firms and selecting a firm to carry out the audit.

Finally, it is important to highlight the role of the treasurer of a nonprofit organization. The treasurer of the board should be someone with financial experience (at the least, a basic understanding of financial management and reporting), preferably related to the operation of nonprofit organizations. Accountants and businesspeople are generally preferred for this job; however, many “for-profit” sector people are not aware of the unique financial characteristics of nonprofits. Because the treasurer typically has a leading role in the financial management of an organization (or even it’s day-to-day activities, if a small organization) it is also important is that this person can make the time commitment necessary to fulfill this role.

**Organizational and Program Planning and Evaluation**

The board should be actively involved with management in developing the mission and vision of the organization. It should review and approve the strategic (long-range) direction and goals prepared by the staff. Boards often also choose to approve annual operating objectives and organizational priorities. In some organizations, a board committee may assist the staff in developing the strategic plan and, especially in small nonprofits, may also help work up the year-to-year objectives.

It is the board that should make sure that programs and program plans are consistent with the organization’s purposes and goals and that these plans are organized and detailed enough so that objectives will be met within the anticipated limits of resources (people, time and money). Unfortunately, too many boards pay more attention to the budget than to the organization’s programs, mainly because a budget, with finite numbers, is easier to “grasp”. In reality, it is meaningless to review a budget without looking at the programs and activities it supports.

Program evaluation is the process through which the actual outcomes of programs (the services the nonprofit exists to provide) are measured against specific objectives. This is an important role for the board, as the staff role in the evaluation process is to evaluate their own work. Because the board is free from the day-to-day operations of a program, board members can review programs more objectively and with a long-range view. Obviously, information on which to evaluate a program or project will be provided by staff, but the board should examine the results.
As with the budget, when the board approves a program or project, it should also specify appropriate times for reports on performance. At least once a year, a board should also evaluate the organization’s overall success, examining completed programs or program periods in light of the organization’s purpose and calculating the final cost of any benefits achieved. Evaluating results helps determine whether something must be done to adjust long-range goals or plans.

Program evaluations are the means by which an organization determines the impact of its programs on the areas on which it focuses. For this reason, it is important that an organization’s goals and objectives are measurable. If a program is doing things that cannot be evaluated or measured, it is difficult to demonstrate that you are achieving anything. There are several common ways to measure outcomes, such as counting the number of people or households served and surveying client or community satisfaction with your programs or projects.

**Fund Raising and Community Relations**

An organization must not only be well managed internally, it is essential that it be well known in its community and that its reputation win additional financial support. All board members should participate, in one degree or another, in fund raising and community/public relations—two activities that go hand-in-hand. Although these activities are not a legal responsibility of the board, acting in this capacity is an obvious and important role for board members.

In this capacity, board members can serve as the organization’s contacts with certain potential funders. Board members should also make personal financial contributions to the organization at whatever level is comfortable for them. (Even a modest donation is symbolically important.) Most importantly, however, an active and committed board (and staff) is probably one of the best fund raising tools an organization can have. After all, who wants to give money to an organization with an unmotivated board? Every board member can help to improve the community’s understanding of the organization’s programs and needs.

**Personnel and Human Resources**

In the chain of command in a nonprofit organization, the board sits at the top. In this position, the board hires the executive director, evaluates his or her performance, and removes him or her when performance is unsatisfactory. In other words, the board is the executive director’s boss. While the board should not interfere in the day-to-day operations of an organization, it should have clear standards of performance for the executive director. Additionally, even though board members are generally not involved in the day-to-day activities of a nonprofit, they should never assume that an executive director or other staff relieves them of their oversight functions.
Having said all of the above however, it is important to note that the board and the executive director should, to the highest degree possible, work as a team. This is especially true in small and starting organizations where the executive director may possibly be the only full time permanent staff person. In this respect, the board should offer support and administrative guidance (hopefully without micromanagement) to the executive director or staff, especially if the board has expertise or experiences in areas where the executive director does not.

The board may determine the salary scales and benefits for the staff, especially if they have professional expertise that the staff does not, and should approve staff-developed and/or help to develop personnel policies. The personnel manual provides information about hiring and firing, vacation and sick days, leaves, performance and salary reviews, working hours and conditions, and benefits. (This topic is more fully discussed in Part IV. Internal Controls.) Staff members who report to the executive director, however, generally should be hired, fired, and evaluated by the executive director, who should also determine their individual compensation within the overall compensation policy approved by the board.

**The Difficult Business of the Executive Director**

Although the law states that the board of directors bears the legal responsibility for an organization, the simple reality is that the board depends heavily on the executive director to ensure that this responsibility is being carried out. After all, board members are volunteers and have their own “work” lives. Because of this, the executive director assumes much of the authority and responsibility over the governance and management of the organization. In a small organization, the executive director’s role may be even larger.

In small organizations, the executive director may be all staff people (administrator, finance director, bookkeeper, program specialist, grant writer, organization spokesperson, janitor, and more) rolled into one person. In organizations where the executive director also provides direct services (e.g., taking applications, qualifying applicants, processing loans, etc. for a housing rehabilitation program), the traditional roles of an executive director are often short-changed.

When an organization is small, the need for a board that is willing to pitch in and help its Executive Director to build the organization is even more critical. The following is a discussion of what is generally identified as management responsibilities. Delineating these activities does not necessarily mean that an Executive Director does all of these activities by him or herself. Certainly, an Executive Director can, and should wherever possible, delegate tasks (to other staff or willing board members) and build the internal support system they need to manage the organization effectively and efficiently. In general, the major responsibilities of an Executive Director include:
Board Administration and Support

In this capacity, the Executive Director of a nonprofit organization is essentially the staff to the Board of Directors and responsible for developing the agendas, and preparing reports and other information for the board’s review, evaluation, and/or approval. This reporting serves several purposes: it is essential to the executive director and other staff who benefit from consultation with and feedback from the board, and it benefits the board in that it keeps up-to-date on issues and lets it know whether the organization needs help and in what areas. This regular reporting and keeping the board informed also reduces the “learning curve” for board members so that they do not have to do a major job of self-education when issues or problems crop up or it begins the next year’s review of proposed programs and budgets.

Financial Management

Generally, it is the responsibility of an Executive Director to recommend a yearly budget for the Board’s approval and adoption. While this task can be undertaken with the assistance of the board or a committee of the Board, it is the Executive Director who has more first-hand knowledge of the financial needs and resources of the organization.

Once a budget is adopted, it is the Executive Director who must then operate the organization day-to-day within the constraints of the budget. This means that the Executive Director must be knowledgeable about the organization’s finances, accounting system, internal operations, and programs, and be able to report to the board with clear and precise information in these areas. This latter task requires the preparation of financial statements and budget reports for distribution to the Board members for discussion at their meetings.

Program Management, Implementation, and Compliance

In smaller organizations, the Executive Director oversees the development, marketing, implementation, evaluation, and ultimately, the quality, of an organization’s programs and projects. This means that the executive director is also responsible, if government funding is used, for ensuring that state and federal rules and regulations are met and that adequate documentation showing this compliance is on file. (Even non-governmental entities, such as foundations, require reporting.)

Planning, Program Development and Policy Making

As in the other areas, and especially in a small organization, the Executive Director shoulders the responsibility for developing new programs and recommending internal policies for the operation of the organization. Policy development can encompass many areas, including internal controls, personnel, financial management, and even assisting the board in developing their own policies for operation (i.e., conflict of interest, etc.).
Fundraising and Public Relations

The Executive Director of an organization must oversee the planning and implementation of fundraising activities, including identifying resource requirements, researching funding sources, establishing strategies to approach funders, submitting proposals and administrating fundraising records and documentation.

Perhaps even more importantly, an Executive Director must ensure that an organization and its mission, programs, projects, and services are consistently presented in a strong, positive image to relevant stakeholders. Most times, an Executive Director becomes, or is, the personification of an organization. This means that the Executive Director must not only ensure that the right message comes across, but that s/he (the “messenger”) is always cognizant of their effect on the message.

Personnel Management

Executive Directors retain the responsibility for all matters of personnel management. In this role, an executive director must recruit, hire, and direct employees, and establish (for the Board’s review and approval) personnel policies that best serve the organization. Occasionally, board members may interfere with an Executive Director’s responsibilities to hire and direct employees. This is an unfortunate example of “micro-management” that can lead to later problems. After all, the Executive Director, and not the board, is the one that must work with his or her employees on a day-to-day basis. As with paid staff, an Executive Director must also oversee the actions of volunteers and hold them accountable for the work they agree to do for the organization.

In a small organization, another important function in this area is that of orienting or introducing new staff to the organization and training them in the requirements of their jobs. Once staff are trained, the executive director’s role becomes one of supervisor and perhaps, most importantly, nurturer. This latter role becomes important in maintaining employee morale, and reducing burnout and staff turnover, an occurrence that can have negative financial, programmatic, and organizational costs. However, while the role of nurturer includes such things as employee recognition, opportunities for professional training and growth, and increased participation in decision-making, the role of supervisor takes in employee evaluation and, as needed, a demand for performance or even departure.
Staffing the Financial Management Function

No small nonprofit organization has the resources to support a full-time accountant with the experience necessary to ensure the day-to-day compliance with accounting, tax, grant, and other regulations. For this reason, it is suggested that organizations secure the services of an accountant or accounting firm with experience in nonprofit accounting. Efforts should be made to find an individual who will volunteer or provide the services at a discounted fee. (How do you know if you don’t ask?) Ideally, these services should include:

- Setting up the books (or if the accounting system is already in existence, periodically checking the system and making changes necessary for efficient operation), recording, reconciliation, and reporting procedures and answering ongoing staff questions;
- Assisting in development of the annual budget;
- Drafting monthly or quarterly budget reports, financial statements, and grant reports (if necessary).
- Meeting and reviewing reports with Executive Director and Treasurer on a quarterly basis.

It is important, however, that the activities carried out by an accountant will not compromise their “independence” if an organization wishes to use this same accountant for audits. In other words, accountants cannot audit their own work. Part V of this Primer discusses this conflict in more detail.

Again, in this activity, experience with nonprofit accounting is vitally important. For this, organizations may find the name of accountants with this type of expertise through the State Chapter of Certified Public Accountants, the local Chamber or Commerce, or in contacting similar organizations.

If possible, hire an administrative assistant with bookkeeping experience (or contract for bookkeeping services or find a volunteer with bookkeeping expertise) to maintain books and records, prepare reconciliations, and work with the outside accounting professional.

Consider using a payroll service to prepare paychecks, tax deposits, and required payroll tax returns. These services typically charge a nominal fee per pay period to perform functions that, if not performed properly, present a high degree of exposure (liability) to any small operation. Such exposure includes a 10 percent penalty for late depositing of federal taxes, interest charged on past due amounts, and even loss of exempt status.
Computers and Accounting Software

While manual accounting and bookkeeping is possible, hopefully, all nonprofit organizations are taking advantage of computers and accounting software to help them manage the finances of their organization. Nonprofit organizations can benefit greatly from computer software that ensures accurate and efficient operation of their accounting and financial reporting systems. Accounting software can: (1) simplify maintenance of the general ledger; (2) improve the accuracy, completeness, timeliness, and usefulness of all financial reports; (3) enter accounting data one time to meet all of an organization’s accounting and financial reporting needs; and, (4) save time by eliminating all or most of the manual record keeping and calculations otherwise necessary.

Most of today’s accounting software allows the user to maintain transaction files from which all the month-end, year-to-date, and year-end journals, general and subsidiary ledgers, trial balances, and other financial reports can be generated. These accounting programs typically only require the use to code transactions according to a chart of accounts—rather than posting or recording transactions in a separate journal or ledger for each account as is done in manual bookkeeping. The software uses the coding to post transactions to the appropriate accounts.

These software programs automatically double-code single transactions, thus automatically performing double-entry bookkeeping. The bookkeeper does not have to make two separate entries in journals, ledgers, or trial balances for each transaction, as is required in manual bookkeeping. Each transaction is entered into the system only once rather than posted manually to multiple journals and ledgers. When journals, ledgers, or trial balances are needed, the software generates them as standard reports based on the information in the coded transaction files. There is no need to maintain separate journals, ledgers, or trial balances as is necessary in manual accounting.

Fully integrated accounting software includes all aspects of accrual basis accounting, such as accounts payable and accounts receivable; entry and automatic allocation of payroll data and time-and-effort activity reports by employee for each pay period; and maintenance of various payroll and activity cost pools, with automatic allocation on multiple bases at the time reports are processed.

Even without an integrated computer-based accounting system, using a computer spreadsheet such as Lotus 1-2-3 or Excel to prepare trial balances can be a significant time-saver. Spreadsheets can also be used to produce many other financial reports and are especially useful if an organization’s other accounting software cannot produce reports in the desired format. If an organization uses computer spreadsheets, they become part of the organization’s official books and records.
In general, software packages used by nonprofit organizations are the same as those used by for-profit businesses, for example Quickbooks and Peachtree. Some software companies, however, have developed “add-ons” to basic accounting software that modifies the software for special purposes, such as for use by non-profit organizations. These add-ons advertise that they can facilitate nonprofit accounting and reporting, allocate program expenses, keep track of restricted grants and produce general and specialized financial reports (including Financial statements and IRS Form 990s) for boards, funders and regulatory agencies, while translating complex accounting jargon into understandable “nonprofit” terms. Additionally, some of these add-ons provide organizations with technical support, for an annual fee, via telephone or email.
Part II. The Budgeting Process

Much of the information contained in this part is adapted from Accounting and Budgeting in Public and Nonprofit Organizations: A Manager’s Guide written by William C. Garner.

Budgeting is one of the single most important planning and fiscal functions undertaken by a non-profit organization. Budgeting is especially important to nonprofit organizations (as opposed to for-profit entities) because they utilize donated resources—other people’s money—for public benefit. What is budgeting? One definition is that budgeting is the careful allocation of scarce resources in pursuit of an organization’s mission, goals and specific objectives for a specific time period, generally the fiscal, or financial year.

What is a Budget?

The Financial and Accounting Guide for Not-for-Profit Organizations describes it this way:

“A budget is a ‘plan of action’. It represents the organization’s blueprint for coming months, or years expressed in monetary terms. This means the organization must have specific goals before it can prepare a budget. If it doesn’t know where it is going, it is going to be very difficult for the organization to do any meaningful planning or budgeting. Unfortunately, in many organizations the process is often reversed and it is in the process of preparing the budget that the goals are determined.

The first function of a budget is to record, in monetary terms, what the realistic goals or objectives of the organization are for the coming year (or years). The budget is the financial plan of action that results from the board’s decisions as to the program for the future.

The second function of a budget is to provide a tool to monitor the financial activities throughout the year. Properly used, the budget can provide a benchmark or comparison point that will be an early warning to the board that their financial goals may not be met. For a budget to provide this type of information and control, four elements must be present:

1. The budget must be well-conceived and have been prepared or approved by the board.

2. The budget must be broken down into periods corresponding to the periodic financial statements.

3. Financial statements must be prepared on a timely basis throughout the year and a comparison made to the budget with explanations of significant deviations (or lack of deviations where one might be expected).

4. The board must be prepared to take action where the comparison in Step 3 indicates a problem."
In other words, budgeting translates planning into the financial and operating realities of an organization. Like planning, it is demanding on the whole organization. But in the end, the budget will be an organization’s most useful guide as the year progresses. The budgeting process will enable you, as an organization, to determine your resource needs, maintain control over the use of the resources, and know how your resources were actually consumed.

**How Is a Budget Used?**

With some exceptions (as in responding to a funder’s request for this information), a budget is an “internal” document. In this respect, a budget is used by an organization for financial planning and cash management throughout the year. An approved and adopted budget provides the control for an organization’s accounting system, where revenue and expenditures are recorded through the organization’s accounting and bookkeeping systems and procedures (See Part III).

For it to be effective as a financial planning and cash management tool, the budget should be reviewed at least quarterly, maybe even monthly. Regular budget reviews, where information is provided by the organization’s accounting system, help determine whether actual income and expenses have deviated from the budget and why. There can be many reasons for differences between actual and budgeted income and expenses--seasonal expenses, unanticipated expenses, delayed funding, insufficient fund raising efforts, an unrealistic budget, etc. When discrepancies arise, the financial plan (the budget) must be revised to reflect the real situation. If your original estimates for expenses and/or income are not realistic, adjust them during regular budget reviews. If the budget review indicates an upcoming crunch or deficit, you must take corrective action to avoid a financial crisis. Such action may include expanding your fund raising and/or cutting back on expenses. The earlier corrective action is taken, the more likely it is that you will be able to avoid cutting back on staff and programs or going into debt. Effective use of the budgeting process allows you to catch small problems and alleviate them before you find yourself in “hot water”.

Another area where the budget is useful is for fund raising. A carefully constructed budget is essential to funding proposals (either for contributions or grant awards). The budget is an indication to funders of your planning and management skills. The funds your program requires must be projected clearly so that the organization’s needs can be understood and accepted by potential funders.

**Who Develops the Budget?**

Typically, an organization’s executive director usually develops the first draft of the budget. However, this process should be carried out with assistance from the board of directors. Often, a board will establish a budget committee to assist the executive director in this work. It should be emphasized that because board members must set long-range goals for the organization, decide on program priorities, and ultimately assume fiscal accountability, it is
What Should a Budget Include?

The budget should include all of the anticipated income and expenditures of an organization during a fiscal year. Income includes earned revenues, for which a service must be performed, such as homebuyer counseling or subcontracted program administration, and contributed revenues, such as monetary grants and contributions, and other donated items, such as equipment, goods, and services. Expenditures include all of the costs of purchasing the services, space, and supplies necessary to operate your organization and its programs.

A budget includes both fixed and variable costs. Fixed costs are those that occur regardless of the level of activity or service. Examples are most salaries, insurance, and rent. Variable costs change directly with the level of use or activity. Postage, printing, and publication costs are usually variable. Telephone expenses are both fixed and variable—there are monthly phone service charges, which are fixed unless you eliminate some phone lines, and charges for long-distance, which vary.

Fixed costs are easier to determine than variable costs, although you should take into account any anticipated changes during the year, such as rent increases and salary increases. You must estimate variable costs as best you can, but you should remember to include seasonal as well as average monthly costs. For instance, postage estimates should include the cost of postage used each month as well as any annual bulk mail permit fee and the cost of the several bulk mailings you may have planned for the coming year.

Developing a Budget

The specific steps taken by organizations as they prepare their budget can take many variations, but the fundamental processes and tasks are much the same no matter what differences exist among organizations, their funding sources and programs. The greatest differences in the budgeting process exist between planning and budgeting for new vs. continuing programs. Importantly, development of the budget should begin three to six months before the onset of the new fiscal year and be approved by the beginning of the new fiscal year.

What does a Budget look like?

A budget is generally laid out in two sections:

- Income (or Revenue)
- Expense (or Expenditures)
Within these two sections, there is a further subdivision into specific income and expense categories. Each of these categories is placed on its own line with a dollar estimate listed beside it. Appropriately, these categories are called “line items”. Another name for a line item is an account. So, when someone refers to the salary account, the reference is to that line item in the budget in which all salary expenditures are grouped.

“Project” budgeting, or budgeting by the functional activities of an organization, allows an organization to track the costs of its different activities. In project budgeting, expenses and revenues that are specific to a certain activity are allocated to the appropriate program categories (or columns of the budget). Thus a grant for a particular project program will be placed in that column of the revenue section of the budget, and the expenses associated with that activity will be placed in its own column of the expense part of the budget. Income that is not tied to (or restricted by) a particular program can be spread across the various columns as needed or desired.

In project budgeting, if an organization has already received (and submitted a corresponding budget) a grant for a particular program or project, the costs contained in the submitted and funder-approved budget would be used for this activity. However, care must be taken in adjusting the revenues and expenses associated with this activity according to the fiscal year covered by the organization’s overall budget.

**The Chart of Accounts**

The line items (or accounts) within an organization’s budget comprise a good portion of the organization’s “Chart of Accounts”. In general, a Chart of Accounts is a numbering scheme used to systematically and consistently identify all the financial transactions (Revenue and Expenditures) and the financial condition (Assets, Liabilities, and Net Assets) of an organization. The Chart of Accounts numbers that you use for your budget line items should be the same as those that appear in your General Ledger (see Part III).

A Chart of Accounts will vary from organization to organization. However, accounts are always ranked in the same ascending order: Assets first, followed by Liabilities, then Net Assets, Revenues, and Expenses. One example of a “Chart of Accounts” takes the following sequence:

**Asset and Liability and Net Asset Accounts (not used in the budgeting process)**

- 1000's Assets
- 2000's Liabilities
- 3000's Net Assets

**Revenue and Expense Accounts**

- 4000's Revenue
- 5000's Cost of Goods Sold (Expense)
- 6000-9000's Expense
There are many ways to break down the same financial information and each organization should decide for itself on an appropriate Chart of Accounts. One way to develop your own Chart of Accounts is to look at the accounts of similar organizations that are well managed, about the same size, and have been around for some time. Compare the various listings of accounts. Are they the same or different from your organization? Does your Chart of Accounts need to take into consideration programs or projects that are different from the samples? An example of a budget format with chart of accounts numbers assigned to individual line items is presented later in this Part.

**Steps in the Budgeting Process**

The budgeting process can be broken down into six steps. These steps begin with an evaluation of the organization’s goals and objectives for the coming year and culminate with regular monitoring of the budget.

**Step 1. Reviewing your Goals and Objectives for the Coming Year**

The first step in budgeting really has nothing to do how many dollars you need or have. Instead, it is a review of what you as an organization want to accomplish in the year to come. This means that the starting point of your budget is your strategic plan, and the annual plans you have developed to achieve your strategic plan. These plans should contain well-planned programs or projects for which funding can be (or has been) secured.

When you have determined in detail your goals and objectives, outlined your activities (programs and projects), and considered your funding sources and any restrictions they may have, you are ready to develop your budget. At this point, you must answer a number of questions about the upcoming year. For example:

- What level of staffing do we need for each activity and what should we pay these staff people?
- What are our space and equipment needs and what will these cost?
- What conferences, publications, and other items are necessary to keep the staff informed?
- How much will it cost to inform the public of your program (to pay for printing, mass mailings, posters, and the like)?
- Are there special one-time expenditures that we should consider for things such as equipment, office space improvements (remodeling), consultants, marketing, etc.?

It should be noted that budgeting for new programs or activities is difficult because you lack the financial records and past experiences to use as a basis for future budgeting. In these cases, it is helpful to discuss expenses with, and review the budgets of other organizations doing projects or programs similar to the one you will be taking on. On the other hand, if you have received funding to carry out a particular program or project, you have hopefully already
developed a budget and this work is already done for you, barring any amendments necessary as the program/project unfolds.

**Step 2. Estimating the Costs of Line Items (Accounts) in Your Budget**

To start this process it is useful to prepare a table outlining expense line items for each functional activity area your organization is undertaking. The following table presents an example of a budget format showing line item costs by functional (programmatic) categories. Your organization may or may not have these costs and it may or may not be working on different programs or projects. Or it may have costs and additional programs that are not included here and need to be added. It should further be noted that at the end, not all programs or projects will have dollars in every line item. If project budgeting is being used by an organization, projected expenses should be allocated to proper categories.

How much will it cost to operate your organization and carry out the activities identified in Step 1? Determining this is not an easy process. One approach is to use information from previous years. If you are carrying out an activity that you have done for several years, then the easiest way to prepare a budget for the coming year is to add a percentage increment for inflation and other factors to the figures contained in the previous year’s financial statement (referred to as actuals) or the current year’s budget.

Obviously, the previous year’s expenses together with projected expenses for the current year are extremely helpful in estimating next year’s expenses. However, each item in the budget should also be examined carefully without reference to another year’s figures. An assessment should be made, item by item, of whether the expenditure is required and if so, how large it should be. In addition, new projects and activities require estimates for which the previous year’s actuals and budget may not be very helpful. In estimating the cost of activities you will undertake in the coming year, three additional considerations should be made:

- Costs should be estimated separately for each line item or account in a format called a “budget narrative”. In the budget narrative for each account, you should explain or show the calculations of how you derived the cost of that particular account. The budget narrative is extremely helpful later, if and when the budget must be adjusted.

- Costs should always be estimated on the high side. Add 5 to 10% to all expense figures. Organizations who budget expenses at a level they think will be correct (with no percentage added) are almost always underbudgeted.

- As you consider the costs of new programs and activities, remember that they will add to overall administrative costs. It is not enough simply to estimate how much you will actually spend on a new program or project. The addition of the program puts an added burden on the administrative staff, space, office equipment, and so on.
As discussed previously, the allocation of costs may be an exercise that has already been done for you. This would be the case in which you have received a grant or a contract for operating a program and there is already an approved budget for this particular activity (again, this budget may need to be adjusted to agree with your fiscal year). In order to describe the allocation process, it is first important to define different kinds of costs and cost allocation methods:

- **Direct costs** relate to and are assigned directly to only one functional program area. An example of a direct cost would be the wages of a staff person whose sole job responsibility is to carry out a first time homebuyer’s program (or if that person provides direct services for two different programs or activities, that portion of their wages/time spent on the particular program), or the materials and construction costs or legal fees associated with developing a 12 unit apartment building.

- **Joint (shared) costs** relate to and can be assigned, on a prorated basis, as a direct cost to more than one activity. An example of joint costs would be rental costs, operation and maintenance of facilities, phones, and so forth. It is necessary, however, to recognize that under Federal programs, shared costs are only reimbursable if an indirect cost rate proposal from an organization has been submitted to and approved by its cognizant agency (see Part VI for more information on this). Importantly, the allocation of shared costs may already be done if you are working from an approved budget for a particular grant or contract.

A good place to start in establishing a budget is with staffing costs. Regular personnel costs typically represent the largest single outlay of resources for a nonprofit organization. In establishing staff costs a separate “mini-budget” for each regular, paid staff position, whether full-time or part-time, should be developed (see example on following page). These separate calculations become part of your budget narrative or an explanation of how you determined the cost of each line item within your budget. Staffing (personnel costs) include:

- **Salaries**: Salary figures should reflect employee income before state and federal taxes are withheld. For staff currently working for your organization, the budget amount can be determined as the current year’s salary plus a raise or cost-of-living increase. However, if you plan to add staff in the new budget year, you can develop salary schedules for various positions by calling similar organizations within your area for request information on their salary schedules. Salary determination should be based on what you need to pay to attract people with the skills you need to perform your services. Importantly, if you do plan to add additional staff in the new budget year, in addition to the wages, benefits, and payroll taxes associated with that person, they will need space and furniture to work, will consume supplies, incur mileage, etc.
Payroll Taxes: include FICA/Medicare and Unemployment insurance. FICA/Medicare equals 7.65% of an employee’s salary (the employee then matches this amount and this must be deducted by you in the payroll process). State Unemployment Insurance is equal to 3.5% of the first $7,000 of the employee’s salary, Federal Unemployment Insurance is 0.8% of the first $7,000 of an employee’s salary.

It should be noted that federal and state withholding taxes do not need to be considered during the budgeting process, but must be collected and submitted to the Federal government by an organization.

Health, Life, and Disability Insurance: Although optional, these types of insurance are benefits provided by most employers to their full-time staff (and often to part-time staff working a certain number of hours weekly). Newer organizations may have to defer offering these benefits until they’re better established. Insurance costs depend on the type and amount of coverage purchased and the ages of the individuals covered (some state laws may restrict differences in rates on the basis of age). Call a couple of insurance agents and ask them for quotes on both health and life insurance (a board member may be able to refer you to reliable agents). Ask similar organizations about their insurance programs and rates. It’s best to have a firm quote before you finalize your budget.

Retirement Plans: Some organizations never establish retirement plans for their employees. Eventually, however, these organizations can find it difficult to retain experienced, talented people. A retirement plan can take many forms. One is for the organization to contribute an amount equal to a set percentage of an employee’s salary to a plan, with the employee responsible for deciding how to invest the funds. This places the fiduciary responsibility for the ultimate outcome on the employee and not the employer. Other places to get information about retirement plans are with the Trust Department of a financial institution or with investment and compensation consulting firms (such as Milliman USA). The bottom line is to get some professional advice before proceeding with any kind of retirement plan.

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<th>Salaries and Related Costs (Sample Budget Narrative)</th>
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<td><strong>Hours Worked/Week</strong></td>
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<td>Executive Director</td>
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<tr>
<td><strong>Salary</strong></td>
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<td><strong>Payroll Taxes (FICA/Medicare, Unemp.)</strong></td>
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<td><strong>Health Insurance</strong></td>
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<td><strong>Life Insurance</strong></td>
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<td><strong>Disability Insurance</strong></td>
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<td><strong>Retirement Benefits</strong></td>
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<td><strong>Total Salaries and Related Costs</strong></td>
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The next category of expenses is general office expenses, such as rent, utilities, insurance, supplies, telephones and Internet service, and so forth. Considerations in estimating the cost of these include:

- **Rent:** If you have existing office space that meets your needs you can use current year figures (taking into consideration any rent increases) to enter this figure into the budget. If you are looking for new space it will be hard to determine an exact rental figure. In this instance, you can identify some potential sites for your office and obtain the “going rate” for these spaces. Be sure to ask what is included on the estimate—custodial care, light, heat, storage, and so on. If you plan to share a facility with another organization, determine the amount of space you will occupy and multiply this by the rate per square foot they are paying.

- **Utilities:** monthly charges for heat, electricity, and water may or may not be included in rent payments. If rent includes utilities, you do not need a separate budget item for them. If you are seeking new office space in the new budget year, ask potential landlords for estimates of monthly utilities payments.

- **Telephone and Internet Service:** phone and Internet rates will vary depending upon the type of service chosen and the number of connections. If you are moving to a new office, don’t forget to figure the cost of installation and add it to the budget. Also, estimate the cost of anticipated long-distance calls.

- **Maintenance:** this can include any regular cleaning services you may contract for and any repairs that may be necessary during the year. Again, the past year’s costs can be used to estimate this line item.

- **Supplies:** includes such items as printer paper, files, envelopes, pens, ink, etc.

- **Equipment:** includes items like computers, copiers, etc.

- **Insurance:** refers to Property, General Liability, and Worker’s Compensation insurance.

- **Printing and Postage:** refers to outsourced printing costs (i.e., Kinko’s, etc.) and general mailing costs.

- **Other Costs include:**

  - **Board and Officers Insurance and Employee Bonding:** see Part IV. Internal Controls for a detailed discussion of these items.

  - **Dues and Memberships:** Organizational dues or professional dues paid on behalf of employees and board members.

  - **Consultants:** Consulting fees cover payments to people who provide services directly to the organization, such as attorneys, accountants, marketing consultants, and payroll
services. Some consulting costs may be applicable to a particular program or project, as in the case of a market analysis for a specific/proposed housing development.

Audits: An audit may not be legally required, but funders may require it; fees for an audit can be considerable and organizations may try to look for a qualified professional who will contribute this service in whole or in part. If an A-133 Audit is required (see Part VI. Managing Federal Funds), the cost is substantially greater (often double) than that of a standard financial audit. The fair share of the cost an A-133 Audit may be an allowable cost to a Federal award if conducted in accordance with the requirements of Circular A-133.

Staff Development: An organization should try to make some funds available to be used by employees for further education and training in their fields, including management development for managers.

Travel: refers to transportation, food, and lodging expenses for official organization business (i.e., conferences, site visits, etc.)

- Project-Related (non-Administrative) Expenses: are the next category of expenses and should be shown first in the expense portion of the budget. For housing programs or projects, these costs would include such things as acquisition, construction and rehabilitation costs, holding costs, infrastructure costs, and downpayment assistance or second mortgage assistance.

**Budgeting for Contingencies/Reserves**

Budgeting for a Contingency/Reserve Account warrants an extended discussion. Many nonprofit organizations believe that they must lose money--or at best, break even--to meet legal requirements. This is a fundamental misunderstanding of the nonprofit concept. A surplus or reserve (that is, an excess of income over expenditures) is not only legal, it is desirable.

Nonprofit organizations do not have owners. Because they “serve the public”, any excess of income over expenditure must ultimately be used for a charitable purpose. The word “ultimately” is important here. Money does not have to be spent right away. It can be put away in some kind of reserve fund. This putting away process is highly desirable and all organizations should strive to put some money away each year.

Generating enough excess income in order to put money away can be facilitated through the budgeting process. This is done by creating an account called “Contingency/Reserve”, which is shown on the expense side of your budget. The amount budgeted on this line should equal to as much as 5% of your total income. However, this amount may vary depending on the following factors:
1. The size of the budget (larger organizations with more income can allocate a smaller percentage).

2. The predictability of levels and sources of income (the less predictable the income, the larger the contingency/reserve should be).

3. The relative stability of the organization (the more unstable or new the organization is, the larger the contingency/reserve should be).

4. The extent to which expenditures are fixed in advance (the less fixed the expenditures, the greater the contingency/reserve should be).

5. The experience of the current management (the less experienced the management, the greater the contingency/reserve should be).

What is the contingency/reserve line item used for? First, it can serve as a form of self-insurance in case some unexpected expense comes up during the year. This is the contingency portion. If at the end of the fiscal year there is still money left over after all contingencies have been taken care of, the line item contingency/reserve becomes simply a reserve. In other words, the unallocated money can be put away in some kind of savings instrument - a savings account, money market fund, or stock-- as determined by the board of directors on the advice of a financial professional. Each year, funds should be set aside in this way until such time as you have 25 to 50% of an entire year’s budget in reserve.

Why is 25 to 50% of an entire year’s budget recommended as a goal for reserve? One reason why a reserve fund is so important is to handle periodic and short-term cash flow problems. Organizations often find that they need to pay bills before there is adequate income to do so. Some funding sources operate on a reimbursement basis only. While it is one thing to defer payment of a bill for copier paper, it is quite another to be late in issuing paychecks for staff. It is important to note, however, that if money from the Contingency/Reserve account is used to handle cash flow problems, it must be replenished later when the projected income is finally received. (It is important to remember, though, that even this procedure has a real cost. By taking money out of a reserve fund, the organization is foregoing certain income by forfeiting interest.)

Another reason to put money in reserve has to do with fund raising. Reserve funds may sometimes be used as matching funds for grant or donations for specific projects. This is especially important at the start of programs or projects for which it may be difficult to get donations, or where a match or cost share is required in order to receive funding.

A sample budget is shown on the table on the following page. As suggested, project related costs are shown first, followed by personnel, office-related costs, and finally, other costs. Contingency/Reserves are shown last and would be contained in the Mgt. & Gen. Column.
### ABC Nonprofit 200X Budget

<table>
<thead>
<tr>
<th>COA #</th>
<th>Expenses Description</th>
<th>Management and General</th>
<th>Program A</th>
<th>Project B</th>
<th>Fundraising</th>
<th>TOTAL</th>
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<tbody>
<tr>
<td></td>
<td><strong>PROJECT RELATED COSTS</strong></td>
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<tr>
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<tr>
<td>5010</td>
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<tr>
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<td>Disability Insurance</td>
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<tr>
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<tr>
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<td>Board and Officers Insurance</td>
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</tr>
<tr>
<td>8010</td>
<td>Dues, Subscriptions, etc.</td>
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</tr>
<tr>
<td>8020</td>
<td>Bank Charges</td>
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<tr>
<td>8030</td>
<td>Audit</td>
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<tr>
<td>8040</td>
<td>Attorney’s Fees</td>
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</tr>
<tr>
<td>8050</td>
<td>Accounting Fees (Tax Return, etc.)</td>
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</tr>
<tr>
<td>8060</td>
<td>Staff &amp; Board Development/Training</td>
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</tr>
<tr>
<td>8070</td>
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<td>8080</td>
<td>Consultants</td>
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<tr>
<td>8090</td>
<td>Travel</td>
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</tr>
<tr>
<td>8100</td>
<td>Loan Repayments (Loan A)</td>
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<tr>
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<td><strong>TOTAL OTHER EXPENSES</strong></td>
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</tr>
<tr>
<td>8200</td>
<td>Contingency/ Reserve</td>
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</tr>
<tr>
<td></td>
<td><strong>TOTAL EXPENSES</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
**Step 3. Allocate Revenue**

The budget should clearly establish what should happen in both revenues and expenditures as a result of your programs or projects, fund raising, and so on. Don’t just outline what you want to spend and assume the money to cover expenses will be found somewhere as the year progresses. Realistically budget the expected sources of income—grants, contracts, fees, and donations of service and supplies—in other words, look at both contributed revenues (including donated non-monetary items) and earned revenues. In the budgeting process, it is necessary to look at what is certain or guaranteed revenue (i.e., you have already received the award letter or signed a contract to carry out a specific service, program or project, etc.) and what is anticipated revenue, for instance donations and contributions.

Importantly, just as Expenses are allocated in the budget on a functional basis (by different activity areas such as “Management and General”, Projects A, B, C, etc., and “Fundraising”), revenues should be matched with expenses by functional areas. (For accounting purposes, however, as will be discussed in the following chapter, Revenues are not required to be identified on a functional basis.) In other words, an organization must project what grant revenues, program fees, etc., will support program expenses and what will support management and administrative costs, and allocate revenue accordingly. As with budgeting expenses, it is likely that some of the work of budgeting revenue to different areas will already be done for you, as is the case when certain funds are specifically earmarked for (or restricted to) particular activities. (Again, timeframe is important, as the grant period may not be the same as your fiscal period.)

As discussed above, it is important to differentiate between unrestricted and restricted revenue. Unrestricted revenue has no particular instructions or limitations as to how it is to be used (although it must still be used to carry out the overall mission of the organization). General donations are an example of unrestricted revenue. Revenue that is restricted by outside parties, on the other hand, does have special conditions for use. These conditions can apply to the time period during which it is to be used, the purpose of its use, or both. A grant for a new piece of equipment can only be used for the purpose that the donor specified. Similarly, a grant for the fiscal year beginning July 1 cannot be used before that date or after June 30. An organization can always request that the person or organization that imposed a restriction lift or change it. However, until such permission is given, restricted revenue must not be used for any other purpose or during any other time period. This means that the requirements of funders must be carefully studied during the budget process. Funding requirements and constraints can often include:

- Form and duration of funds (i.e., three-year grant) and method of payment
- Allowable and unallowable line-item costs (uses)
- Cost factors for indirect, administrative, and support expenses
Unit costing, procurement, reimbursement rates, and other standards

Once restricted and unrestricted revenues have been separated, the process of allocating income is as follows:

- Put all restricted income into the proper program activity or category. That is, any income clearly attributable to a specific project should be put into that category and so allocated. Later on, if the budgeting team begins cutting back programs or reallocating income, it is important to remember that these funds cannot be transferred from one program category to another.

- Cover all of the most basic administrative costs with unrestricted income.

- Allocate the balance of unrestricted income across all the programs and activities listed. You may want to allocate it on a percentage basis as was discussed in connection with allocating expenses. Or you may want to use a simpler method and divide the money up on a roughly equal basis among programs.

- Understate all income estimates by 5 to 10%. Just as you left some margin for error on expenses, be equally conservative on income forecasting.

The following table shows a sample format for the revenue part of the budget.

<table>
<thead>
<tr>
<th>COA #</th>
<th>Revenues</th>
</tr>
</thead>
<tbody>
<tr>
<td>4000</td>
<td>Fees for Service (i.e., mortgage loan underwriting fees)</td>
</tr>
<tr>
<td>4010</td>
<td>County Contract (i.e., administration of CDBG infrastructure grant for County)</td>
</tr>
<tr>
<td>4020</td>
<td>NAHTF Operating Grant</td>
</tr>
<tr>
<td>4030</td>
<td>Contributions</td>
</tr>
<tr>
<td>4040</td>
<td>In-Kind Contributions</td>
</tr>
<tr>
<td>4050</td>
<td>Project Proceeds</td>
</tr>
<tr>
<td></td>
<td><strong>Restricted (must be used for specific projects/ programs)</strong></td>
</tr>
<tr>
<td></td>
<td>Program A</td>
</tr>
<tr>
<td>4060</td>
<td>CDBG Grant</td>
</tr>
<tr>
<td>4070</td>
<td>Loan Repayments</td>
</tr>
<tr>
<td></td>
<td>Project B</td>
</tr>
<tr>
<td>4080</td>
<td>HOME Grant</td>
</tr>
<tr>
<td>4090</td>
<td>NAHTF Grant</td>
</tr>
<tr>
<td>4100</td>
<td>Predevelopment Loan (specific to Project B)</td>
</tr>
<tr>
<td>4110</td>
<td>Project Loan (specific to Project B)</td>
</tr>
</tbody>
</table>

**Step 4. Compare and Adjust (Balance the Budget)**

After you have estimated all your expenses and identified all your revenues, a comparison of the two often points out that some line items must either be eliminated or adjusted if your budget is going to balance (Expenses equal Revenues). Usually an organization finds that
there is more expense than income, however, in the enviable case where revenues exceed expenses. Decisions on where and what to adjust must also be made. Remember that it is not necessary to “immediately” expend (and therefore budget) excess revenue. This excess can be placed in reserve for future projects. If the current surplus is large enough, an organization should revisit its strategic plan and consider new projects.

The most obvious ways to balance your budget (in the instance where expenses exceed revenues) is to eliminate certain line items or reduce their costs. Perhaps you can find an attorney to provide you services on a volunteer basis or at a reduced rate. Maybe you decide to give your employees a lesser raise in pay than you originally budgeted. Maybe you can find less expensive office space (although there would be new costs associated with moving). Perhaps your contingency/reserve account needs to be reduced. And so on…

Following the budgeting process described so far, figures should be skewed conservatively. That is, income has been understated, expenses overstated, and roughly 5% of total income has been put in the contingency/reserve category. Even though the budget is balanced on paper, it may appear that there is more money coming in than going out. Careful budgeting, however, requires this approach. It is almost always the case that certain expenses have been forgotten, and certain anticipated income will come in short. In the event that the actual financial picture results in income far exceeding expenses, the board has the enviable task of deciding what to do with the additional money.

**Step 5. Approve and Adopt**

Once the budget has been worked out, it is necessary for the full board of directors to meet and discuss and approve/adopt it. This is one of the most important areas where the board exercises its fiduciary responsibilities as trustees for the organization.

**Step 6. Monitoring (Budget Reports)**

Budget (also called Budget-to-Actual) reports are internal working documents prepared throughout the fiscal year for managers and board members. These reports take information from the organization’s accounting system and other records to assure that revenues and expenditures are in line with the adopted organizational budget. Budget Reports are not financial statements (discussed in the following chapter), which are prepared by the accounting system for external (public and governmental) distribution.

There are two basic types of budget reports needed by an organization: one for expenditures and one for revenues. These reports may be shown on separate pages or on the same page. Importantly, these reports are relatively simple to set up with or without a sophisticated accounting system and are equally simple to maintain once a routine is established. All the data required for these reports should be part of the basic financial information of an organization. The Budget Reports should be prepared monthly, if possible.
### Expense Reports

The Expense Report is set up to discriminate between and separately identify current-month (or quarter or six-month) expenses, cumulative past expenses, projected recognized and recorded future costs, and estimated balances.

- The first column of figures in the report shows the total amount assigned to each line item as contained within your approved budget.
- The second column shows the dollar and percentage outlay of funds for the reporting period (current month, quarter, etc.) for each line item.
- The third column shows the cumulated dollar and percentage outlays for all line items for the year-to-date.
- The fourth column shows all expenses that have not yet been paid. This column will include some estimated future costs that are not actually certain but are approximate or straight-line projections based on previous activities or experiences.
- The final column shows the differences between total outlays (Column 3) plus projected expenses (Column 4) and budgeted line-item amounts (Column 1).

The following table shows how this format is set up. For simplicity, only a few line items are included, however, in an actual summary, information would appear for every line-item in an organization’s budget.

<table>
<thead>
<tr>
<th>Expense Account #</th>
<th>Line Item</th>
<th>Budgeted Total (12 months)</th>
<th>Current Quarter Expenses</th>
<th>Year to Date (6 months) Expenses</th>
<th>Projected (next 6 months)</th>
<th>Estimated Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>6000</td>
<td>Salaries</td>
<td>$</td>
<td>%</td>
<td>#</td>
<td>%</td>
<td></td>
</tr>
<tr>
<td>6010</td>
<td>Payroll Taxes</td>
<td>$</td>
<td>%</td>
<td>#</td>
<td>%</td>
<td></td>
</tr>
<tr>
<td>6020</td>
<td>Health Insurance</td>
<td>$</td>
<td>%</td>
<td>#</td>
<td>%</td>
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</tr>
<tr>
<td>7000</td>
<td>Office Rent</td>
<td>$</td>
<td>%</td>
<td>#</td>
<td>%</td>
<td></td>
</tr>
<tr>
<td>7010</td>
<td>Utilities</td>
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<td>%</td>
<td>#</td>
<td>%</td>
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</tr>
<tr>
<td>7020</td>
<td>Insurance</td>
<td>$</td>
<td>%</td>
<td>#</td>
<td>%</td>
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</tr>
<tr>
<td>7050</td>
<td>Telephone</td>
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<td>%</td>
<td>#</td>
<td>%</td>
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<tr>
<td><strong>TOTAL EXPENSES</strong></td>
<td><strong>$</strong></td>
<td><strong>%</strong></td>
<td><strong>#</strong></td>
<td><strong>%</strong></td>
<td><strong>#</strong></td>
<td><strong>%</strong></td>
</tr>
</tbody>
</table>

In preparing an Expense Report, it should be understood that every type of obligation of the organization must be accounted for somewhere on the Report. For example, if the cost of a particular item was paid for or incurred during the month, it will appear in Columns 2 and 3. If, however, it is still projected, it must appear in Column 4. Also, each staff member’s salary for the month will appear in Columns 2 and 3; but the rest of the total amount still due that
person for the remainder of the fiscal year must appear in Column 4. The same is true for travel expenditures: those already completed must appear in Column 2 or 4; those anticipated go into Column 4.

In some instances an obligation may be reported either in Column 2 or in Column 4. For example, if payroll taxes have not yet been paid for the current quarter, they may be reported as part of the current expenses or as part of committed future expenses. The same holds for many other “payables”. Each organization should decide which ways are most practical for its needs. However, a consistent routine should be followed, or at least applied to the same items each month. For example, if it makes better sense to report payroll taxes in Current Expenses, then they should be reported that same way throughout the fiscal year.

It is important to have a separate discussion of what makes up column 4. Information in this column is not the difference between the budgeted amount and the year-to-date expenses. If this were the case, the estimated balance would always be zero, everything would always be “right on target” and the usefulness of the summary would be severely compromised. Rather, information used to prepare Column 4 includes both that available from existing accounting records (purchase orders, payroll, and so on) and that derived by extrapolating known or probably future expenses that have not yet been recorded as financial transactions (e.g., payroll projections, planned or budgeted purchases). The bases for projecting future expenses will usually vary from line item-to-line item; however, the straight-line method (extrapolating an average monthly amount from actual expenditures) should be used only if a better basis is not available.

Deviations from the budgeted amount should be explained in a footnote or an attachment to the Expense Report. If the percentage of year-to-date expenses is higher or lower than the projected amount, explain. Did a staff person resign, was additional staff added to handle a special project, etc.

**Revenue Reports**

Monitoring and controlling revenues pose similar problems to monitoring and controlling expenses. Nonprofit organizations receive and are accountable for many kinds of revenue: including, but not limited to, grants and other awards, allocations, service fees, contributions, reimbursements, interest, even loans. These may be wholly or partially restricted (designated for specific purposes) or unrestricted. They may be expendable only for current (or future) operations or only for capital improvements. They may be received in lump sums, arrive at specific intervals, or dribble in erratically. They may be provided only on a reimbursement basis. Whatever the source, purpose, or timing, revenues must be as carefully handled and accounted for as expenses. It is easier to identify many kinds of future expenses (salaries, rent, payroll taxes) than to evaluate anticipated revenues. However, approximations, even if not completely reliable, are important and very useful.
A Revenue Report (as shown below) parallels the expense report. Each shows how much was received/spent for that month, how much has been received/spent for the year to date, and the balance. Other columns in the Revenue Summary indicate how much an organization has pledged, contracted, or owed to it, in essence, establishing an accrual revenue system. As with the expense report, any projected amounts shown in Column 4 should be carefully detailed in special notes or attachments to the report. It should be noted that Column 5 “Adjusted Total Expected” is an estimate of expected revenues for the whole year. Because of changes in revenue streams, it may or may not be the same as the budgeted amount.

<table>
<thead>
<tr>
<th>Revenue Account #</th>
<th>Revenue Source</th>
<th>Budgeted Total (12 months)</th>
<th>Amount Received &amp; Accrued this Quarter</th>
<th>Amount Received and Accrued YTD (6 months)</th>
<th>Pledged/Contracted/Owed YTD</th>
<th>Adjusted Total Expected</th>
<th>Plus/Minus Balance</th>
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</thead>
<tbody>
<tr>
<td>4000</td>
<td>Fees for Service</td>
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</tr>
<tr>
<td>4010</td>
<td>HOME Grant</td>
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</tr>
<tr>
<td>4080</td>
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<tr>
<td>4090</td>
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<td>TOTAL REVENUES</td>
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</tbody>
</table>

Based on information contained in the budget reports, it may become apparent that there is a need to modify the budget. Obviously, changes in the allocation of money to expenditure accounts or functional areas result in either supplementing (adding) or cutting originally budgeted amounts. Budget modifications must appear in budget reports, and the operating plans should be revised accordingly. These changes should follow a formal process that corresponds to the procedures and method used to prepare the original budget. This means that the board of directors should approve all amendments before they are made in the organization’s accounting system. Alternatively, the board may choose formal approval or adoption of budget amendments above a certain dollar amount.
Part III: The ABCs of Accounting

This Part is intended to introduce executive directors (and other staff) and board members to the basics of accounting. Why bother to learn this? Well, it should be stated at the outset that it is recommended that nonprofit organizations without an in-house capacity for accounting (that is a fiscal officer or staff accountant), contract for this work. (This will be covered more fully later in the chapter.) However, even with someone else doing your accounting work for you, it is important that you know the basics.

Many nonprofit organizations are unfamiliar with even basic accounting methods. However, obtaining a basic knowledge of nonprofit accounting practices and principles is worth the effort. Why? First of all, understanding how things are done and why from an accounting perspective will broaden your understanding of financial management. In this respect, it will help you more effectively manage the overall operations of your organization. Secondly, it will help you work with your accountant in establishing an accounting system that effectively serves your organization. This can lead to reduced costs later (when you are able to provide an auditor with all the information they need to perform an audit, rather than have them attempt to reconstruct your activities during the year).

The purpose of an accounting system is to record, classify and summarize business activity. In other words, an accounting system keeps track of where your money comes from and where it goes. This part is intended to introduce you to basic accounting methods and the types of records you will need, and familiarize you with the components of an accounting system and how they work together to manage your resources. You will also learn common accounting terms and find out about different financial statements. While not intended to teach you accounting, an effort is made to outline those areas that are critical to fulfilling the fiscal responsibilities that fall to board members and staff.

What do you need from an accounting system? Well, an accounting system should:

- Accurately reflect your organization’s current financial condition. And do so in a timely fashion.
- Be clear, logical and easy to use. Information should be understandable to management and the board of directors without the needs for complex interpretation by an accountant.
- Provide useful information that board members and staff can use in making decisions and achieving goals.

In order to gain an understanding of accounting it is sometimes helpful to begin at the end. That is, with the standardized financial statements and reports that every nonprofit organization is required to produce.
Financial Statements

There are certain standardized financial statements (also called GAAP Statements, where GAAP stands for “generally accepted accounting principles”) that nonprofit organizations must prepare each year. These standards are developed by the Financial Accounting Standards Board (FASB - pronounced fāz-bee), who, since 1973, has been the designated organization in the private sector for establishing standards of financial accounting and reporting. Over the years, FASB has issued over one hundred Statements of Financial Accounting Standards. Because FASB is the official rule-making body for all private financial accounting, it develops standards for the financial accounting and reporting of all private entities – both for-profit and not-for-profit (this is as opposed to GASB or the Governmental Accounting Standards Board). These standards are officially recognized as authoritative by the Securities and Exchange Commission (SEC) and the American Institute of Certified Public Accountants (AICPA).

Of particular importance here is the Statement of Financial Accounting Standards No. 117, Financial Statements for Not-for-Profit Organizations (also called FAS-117). There are many more FASB Statements of Financial Accounting Standards of relevance to nonprofit organizations as well as FASB Statements of Financial Accounting Concepts of importance, however FAS-117 is where we will turn our focus.

FAS-117 describes the purpose of a set of financial statements as follows:

4. The primary purpose of financial statements is to provide relevant information to meet the common interests of donors, members, creditors, and others who provide resources to not-for-profit organizations. Those external users of financial statements have common interests in assessing (a) the services an organization provides and its ability to continue to provide those services and (b) how managers discharge their stewardship responsibilities and other aspects of their performance.

5. More specifically, the purpose of financial statements, including accompanying notes, is to provide information about:
   - The amount and nature of an organization’s Assets, Liabilities and Net Assets
   - The effects of transactions and other events and circumstances that change the amount and nature of Net Assets
   - The amount and kinds of inflows and outflows of economic resources during a period and the relation between the inflows and outflows
   - How an organization obtains and spends cash, its borrowing and repayment of borrowing, and other factors that may affect its liquidity
   - The service efforts of an organization.

So when board members and others want to assess the organization’s financial health, they will look at three financial statements as described in FAS-117: the Statement of Financial
Position, the Statement of Activities, and the Statement of Cash Flows. Knowing what each of these statements contains, what they mean and how to read them is extremely important.

**Statement of Financial Position (The “Balance Sheet”)**

The Statement of Financial Position, is a “freeze frame”, or snapshot of an organization’s financial condition as of a particular date (usually the last day of the month of the fiscal year). It summarizes the value of what an organization owns and what is owed to it (Assets), what it owes (Liabilities), and how much is left over (Net Assets). The Statement of Financial Position must report and focus on the organization as a whole and contain the following elements:

- **Total Assets**: reported in similar groups, such as cash and cash equivalents, receivables, short-term loans, inventories, deposits and prepaid expenses, and long-term investments.
- **Total Liabilities**: reported by groups such as accounts payable, accrued payroll, other accrued expenses, deferred and unearned revenue, funds due to grantors, short-term loans, mortgages, and other long-term Liabilities.
- **Net Assets**: reported by three groups based on whether or not there are donor-imposed restrictions. (Net Assets are the equivalent to “equity” in a for-profit organization, and were formerly referred to as the “Fund Balance”.) The three groups used to categorize Net Assets are:
  1. **Unrestricted Net Assets**, which are limited only by the nature of the organization, self-imposed restrictions, and/or the mission of the organization as specified in its articles of incorporation and bylaws. In other words, Unrestricted Net Assets are monies that can be used by an organization to further its mission—for providing services, producing goods, raising contributions, and performing administrative functions. Separate line items are often shown within this category to show such things as unrestricted Net Assets that are invested in fixed Assets (i.e., land and buildings, etc.).
  2. **Temporarily Restricted Net Assets**, which are those Net Assets whose use by the organization has been limited by donors to: (a) a later period or after a specified date (time restrictions), and/or (b) to a specified purpose (purpose restrictions).
  3. **Permanently Restricted Net Assets**, which are those Net Assets that must be maintained by an organization in perpetuity. These are Net Assets for which donor-imposed restrictions limiting an organization’s use of the Asset or its economic benefits neither expire with time nor can be removed by the organization meeting certain requirements. A “classic” example of Permanently Restricted Net Assets are works of art donated to a museum to be maintained permanently in its collection. Another is an Endowment Fund in which only the interest from the Endowment can be used for certain purposes (in this case, the interest would be classified as a Temporarily Restricted Net Asset).
The Statement of Financial Position is sometimes called a “balance sheet” because its two halves add up to the same total number. The top (or left) half of the statement lists all of the organization’s Assets or everything that the organization “owns”. The bottom (or right) half of the statement lists both the organization’s Liabilities—everything that it owes, and its Net Assets. Thus the “balance” is between Assets on the one hand (left) and Liabilities and Net Assets on the other (right). The following formulas further define how Net Assets are calculated:

\[
\text{Assets} = \text{Liabilities} + \text{Net Assets} \quad \text{or} \quad \text{Assets} - \text{Liabilities} = \text{Net Assets}
\]

In other words, using these formulas, if an organization knows how much it owns and how much it owes, the difference between the two is its Net Assets. In a profit-making entity, Net Assets are referred to as profit or owner’s equity. In a nonprofit organization where there are no owners and no profits, the Net Assets shows the organization’s financial Net worth when all its financial obligations are subtracted from all of its cash and non-cash Assets. Net Assets provides a link to the Statement of Activities (see the following), because an organization’s financial Net worth is obviously affected by the Net income (or loss).

It should be noted that a large and positive balance in Net Assets does not necessarily mean a financially sound organization. In order to determine financial stability, one must look at the source of the organization’s Assets. For instance, an organization could own land and buildings, while being cash poor and saddled with debts. Although land and buildings are “a good thing”, an organization that has to sell Assets to pay debts is not considered financially healthy. On the flip side, any organization with a better than two-to-one ratio between cash (an Asset) and Liabilities could possibly have too much money in a cash account. Additionally, depending on the size and type of its Assets (i.e., cash), it should probably consider program expansion.

The following table shows a sample format of a Statement of Financial Position as recommended by FAS-117. It should be noted that this table shows only a selection of some categories of Assets and Liabilities and these may or may not fit the needs of your particular organization. In other words, these are provided as an example only. As you can see from the table, the “bottom line” (well actually, the second to the bottom line) of the Statement of Financial Position is an organization’s Net Assets, or what it would be “worth” or, have to spend, on a particular day if it used all its Assets to pay off all its Liabilities. Comparing this number to the previous year’s Net Assets shows whether an organization’s “Net worth” is decreasing or increasing.

One final note regarding the following statement format: while “Permanently Restricted Net Assets” are shown as a category of Net Assets, it would be highly unlikely for small housing-related or community development-related nonprofit organizations to hold such Net Assets.
### ABC Nonprofit Statement of Financial Position

**As of June 30, 2002**

**with Summarized Financial Information for 2001**

<table>
<thead>
<tr>
<th></th>
<th>2002</th>
<th>2001</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash in Bank</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Prepaid expenses</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Grants and other receivables</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current Portion of Loans Receivable</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investments</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loans receivable</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investments</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other Assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fixed Assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Buildings</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Property and Equipment</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Equipment and furniture</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Less accumulated depreciation</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net Fixed Assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>TOTAL ASSETS</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Liabilities</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accounts payable</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accrued Expenses - Payroll</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accrued Expenses - Payroll taxes</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accrued Expenses - Other</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loans and notes payable - long-term</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loans and notes payable - short-term</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mortgages payable</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>TOTAL LIABILITIES</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Net Assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Permanently Restricted</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Temporarily restricted</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Unrestricted</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>TOTAL NET ASSETS</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>TOTAL NET ASSETS AND LIABILITIES</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Statement of Activities

Unlike the Statement of Financial Position, which tells only where the organization’s finances stand as of a particular moment in time, the Statement of Activities helps determine whether the organization had a surplus, a deficit, made any unusually large expenditures, or had any revenue windfalls during a certain time frame. It does this by summarizing financial activity over a period of time (often a month or a quarter or a year).

Where the Statement of Financial Position displays financial information according to Assets and Liabilities (again at a specific point in time), the Statement of Activities contains information about contributions and other revenues, expenses, gains, and losses—in other words, the amount of change in an organization’s Net Assets over a specific period. This statement also summarizes expenses for programs, management and general, and fundraising. In contrast to the Statement of Financial Position, the Statement of Activities tells about an organization’s sources of income (i.e., how it is earned, how dependent an organization is on certain kinds of funding, etc.) and its expenditures (i.e., how much is spent on specific programs or activities).

The “bottom line” of the Statement of Activities is a determination of the organization’s change in Net Assets resulting from its activities during the year. Simply put, change in Net Assets is the excess (or deficit) of revenues over expenditures during the fiscal year (or Revenues minus Expenditures). The “change in Net Assets” is added to the total Net Assets of the organization at the beginning of the year (end of the preceding year) to reach the total Net Assets at the end of the reporting period. This total Net Asset amount must be the same as the total Net Asset amount reported in the Statement of Financial Position (although these figures are derived separately).

The table on the following page shows the format for the Statement of Activities. Again, categories of Revenues and Expenses will not be the same in all organizations. Unlike the Statement of Financial Position where the organization’s overall “worth” is reported on, the Statement of Activities reports on Revenues and Expenses (and consequently change in Net Assets) by category: Unrestricted, Temporarily Restricted, and Permanently Restricted (again, it would be extremely unusual for a small nonprofit to have “Permanently Restricted” Net Assets).

How does the Statement of Activities provide additional information in helping to evaluate an organization? One reason is that two different organizations could have identical Statements of Financial Position but one could be improving its financial condition (be on its way up) and the other could be rapidly deteriorating. When you add the Statement of Activities to the picture, you find out the nature of an organization’s activities, such as how dependent it is on grant funding, how much of its funding is restricted to certain activities and how much can be used to further the general activities of the organization, and so forth.
### ABC Nonprofit Statement of Activities
#### Year ending June 30, 2002
With Summarized Financial Information for 2001

<table>
<thead>
<tr>
<th></th>
<th>Unrestricted</th>
<th>Temporarily Restricted</th>
<th>Permanently Restricted</th>
<th>Totals</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Program A</td>
<td>Program B</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Revenues</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Contributions</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Federal Grants</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>State Grants</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other Grants</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gifts in kind - tangible</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rents from investment property (gross)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>deduct related rental expense</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Program service fees</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gross Amount from Sale of Other Assets</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>deduct other costs and sales expense</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest on Savings</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Miscellaneous income</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Unrealized gain (loss) on investments</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net Assets released from restrictions</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>TOTAL REVENUE</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Expenses</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Project/Program A</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Project/Program B</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Program Service Expenses</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Management and General</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fundraising</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Supporting Service Expenses</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>TOTAL EXPENSE</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**CHANGE IN NET ASSETS**

**NET ASSETS, beginning of year**

**NET ASSETS, end of year**

### Statement of Cash Flows

Cash flow in the for-profit sector applies only to the movement of cash in and out of a business (i.e., credit transactions are not considered part of a for-profit entity's cash flow). In the non-profit sector, however, cash flow is the flow of “liquid” Assets (investment with a maturity of three months or less) into an agency whether by cash or credit (i.e., notes payable). In general, the Statement of Cash Flows starts with the “change in Net Assets” from the Statement of Activities. Because this figure includes accrual items and depreciation, the change in Net Assets must be adjusted to reflect the affect of these items, for instance, depreciation. The Statement of Cash Flows provides relevant information about the cash flow...
receipts and cash payments (disbursements) of an organization during a reporting period. Additionally, donors’ pledges (unconditional promises to contribute) must be included in this statement in the year the pledge is made. The Statement of Cash Flows must show:

- Cash flows from operating activities, including Net cash used by operating activities
- Cash flows from investing activities, including Net cash used by investing activities
- Cash flows from financing activities, including Net cash used by financing activities
- Net increases or decreases in cash and cash equivalents
- Cash and Cash equivalents at the beginning for the year
- Cash and cash equivalents at the end of the year, including a reconciliation of changes in Net Assets to Net cash used by operating activities.

The “bottom line” of the Statement of Cash Flows is “Cash and Cash Equivalents, end of year”—a figure which must match the first line item in the Statement of Financial Position (“Cash in Bank” or “Cash and Cash Equivalents”). The table below provides a sample format for this Statement.

<table>
<thead>
<tr>
<th>ABC Nonprofit Statement of Cash Flows</th>
</tr>
</thead>
<tbody>
<tr>
<td>Year ending June 30, 2002</td>
</tr>
<tr>
<td>With Summarized Financial Information for 2001</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Totals</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash Flows from Operating Activities</td>
</tr>
<tr>
<td>Change in Net Assets (from Statement of Activities)</td>
</tr>
<tr>
<td>Adjustments to reconcile change in Net Assets to Net cash by operating activities:</td>
</tr>
<tr>
<td>Depreciation</td>
</tr>
<tr>
<td>Decrease (increase) Accounts receivable</td>
</tr>
<tr>
<td>Decrease (increase) Grants Receivable</td>
</tr>
<tr>
<td>Decrease (increase) in prepaid expenses and deferred charges</td>
</tr>
<tr>
<td>Decrease (increase) in other Assets</td>
</tr>
<tr>
<td>Increase (decrease) in accounts payable and accrued expenses</td>
</tr>
<tr>
<td>Increase (decrease) in unearned revenue</td>
</tr>
<tr>
<td>TOTAL ADJUSTMENTS</td>
</tr>
<tr>
<td>NET CASH USED BY OPERATING ACTIVITIES</td>
</tr>
<tr>
<td>Cash Flows from Investing Activities</td>
</tr>
<tr>
<td>Purchase of Property and equipment (fixed Assets) – (negative value)</td>
</tr>
<tr>
<td>Proceeds from sale of Investments – (positive value)</td>
</tr>
<tr>
<td>Purchase of investments – (negative value)</td>
</tr>
<tr>
<td>NET CASH USED BY INVESTING ACTIVITIES</td>
</tr>
<tr>
<td>Cash Flows from Financing Activities</td>
</tr>
<tr>
<td>Payments on long-term debt – (negative value)</td>
</tr>
<tr>
<td>NET CASH USED BY FINANCING ACTIVITIES</td>
</tr>
<tr>
<td>NET INCREASE (DECREASE) IN CASH and CASH EQUIVALENTS</td>
</tr>
<tr>
<td>CASH and CASH EQUIVALENTS at beginning of year</td>
</tr>
<tr>
<td>CASH and CASH EQUIVALENTS at end of year</td>
</tr>
</tbody>
</table>
Statement of Functional Expenses

Although not required by FASB, the Statement of Functional Expenses reports the total expenditures of an organization by both functional expenses (expenses for each program and for supporting services such as Management and General and Fundraising) and by object expenses, such as salaries, occupancy, and travel. It is recommended that all organizations prepare this report, in addition to the other three required statements. There are several good reasons to take the time to produce a Statement of Functional Expenses: (1) this information must be compiled (anyway) in order to be able to produce the Statement of Activities; and (2) nonprofit organizations required to file IRS Form 990 are required to report expenses by object category and this statement provides the required information.

<table>
<thead>
<tr>
<th>ABC Nonprofit Statement of Functional Expenses</th>
<th>Year ending June 30, 2002</th>
<th>With Summarized Financial Information for 2001</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Project A</td>
<td>Program B</td>
</tr>
<tr>
<td>Expense</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Salaries and Wages</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Employee benefits and Payroll taxes</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Personnel</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Supplies</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Telephone</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Postage</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Office Rent</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Utilities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Equipment</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Professional Fees</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Travel</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Dues and Memberships</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Insurance</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Depreciation of Buildings and Equip.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Consultants</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other Non-personnel Expenses</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Functional Expenses</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Notes to Financial Statements

Notes to financial statements are as essential to the complete understanding of any financial report as the actual Statements (tables). Any information that is needed in order to fully understand a financial statement should be included in a note. The following are examples of information contained in notes:

- a summary of significant accounting policies (such as method and basis of accounting system, methods of depreciation, methods of allocating expenses among functions, projects, and grants, etc.);
- types and amounts of investments, and realized and unrealized investment gains and losses;
- purpose and type of debts, including sources of repayment and description of land and buildings used as security for any debt; and,
- methodology for classifying Net Assets.

So, now that you know what the “output” of an accounting system should be, it is important to turn to the system itself. That is, what its characteristics should be and how entries into the system can produce standardized reports.
Setting up your Accounting System

As stated previously, your organization's accounting (and bookkeeping) system should be set up by an accountant familiar with nonprofit organizations. This person should also teach you how to use it and be available to provide assistance when you need it. Because nonprofit accounting is different from for-profit accounting, it is critical that this person understands the concepts needed to provide you with a system to meet your needs.

Before we get to the “nitty gritty” of accounting, however, it is important to describe two aspects of an accounting system that should be instituted by all nonprofit organizations. The first is an accounting method called “accrual based accounting”. The second is a method of classifying expenses by their function within an organization's activities.

Accrual-based Accounting

There are two common bases for accounting systems. The first, cash basis accounting, is simple and straightforward; the second, accrual-based accounting, while more complex, provides a more complete view of the organization’s fiscal condition. Many nonprofits choose to operate on a “cash basis”. However, this primer recommends that all nonprofit organizations set up their accounting system using the accrual method. The reason for this is in the differences between the two.

Cash basis (or cash-based) accounting. People are most familiar with cash basis accounting because this is how they maintain the financial records for their personal checking and saving accounts. When a person receives money and deposits it in the bank, the deposit is recorded as income and added to the bank account balance. When cash is withdrawn from the bank (or when a check is written), the transaction is recorded as an expense and the amount is subtracted from the bank account balance. The cash basis accounting system is quite straightforward if all a person needs to know is how much money is in the account. However, it reveals little about financial condition of the person maintaining the account, because it tells nothing about what that individual owes and how much is owed to him or her.

So, in cash basis accounting, an expense is recognized and accounted for (recorded) only when funds are actually paid out for a service or product. For example, if an item is ordered or bill for services is received, it is not recognized as an expense until a bill is paid. This permits the organization to use simple bookkeeping procedures, but does not reflect the financial condition of an organization.

Accrual-based accounting. Individuals engage in a form of accrual-based accounting when they think about outstanding bills and yet-to-be-received paychecks to determine if they can afford to buy something “special”. Accrual-based accounting recognizes expenses not only when money changes hands but also when expenses are incurred and revenues are awarded. This system recognizes a financial obligation from the moment a bill is received or expenses
are incurred or accrued and the amount is deducted from the organization’s Net worth at that time. (The amount is reflected in the financial statements as a “payable” until the check is actually written, but more on that later.) Similarly, the system recognizes an official notification of funding (e.g., a grant) as income as soon as the letter is received. (The amount is entered on the books as a “grants receivable” until a check is actually deposited, again, more on this later.)

**Why Choose the Accrual based Accounting Method?**

Although cash basis accounting is much simpler than the accrual method, it really only tells an organization whether there is sufficient cash in the bank to pay the bills. Accrual based accounting shows you the financial condition of your organization, which is much more revealing than knowing your bank balance.

An example by Garner explains: Say an organization with no money in the bank borrows $30,000 to pay $20,000 of outstanding bills and then deposits the remaining $10,000 in its bank account. On a cash basis, a financial accounting would only reveal a positive cash balance of $10,000. On an accrual basis, the outstanding loan of $30,000 would be taken into account and the organization would show a Net worth of -$20,000. From the point of view of a prospective board member, a funder, or anyone else attempting to assess the organization’s fiscal condition, the second figure would give a more accurate picture.

When adopting the accrual method, you must decide what to recognize and record as an expense and when to record it. It is recommended that, with minor exceptions, all obligations and grantor commitments be recorded as soon as possible. This does not mean that expenses are recorded as budgeted (i.e., identifying the remainder of the salaries as accrued expenses). That is for the budget reports described in the previous chapter. What it does mean is that as soon as you receive a bill (with satisfactory fulfillment of whatever the bill was for), or as soon as you actually have accrued expenses (employees worked the hours for which they have yet to be paid), these should be recorded.

Another advantage to using the accrual-based method is that it eliminates the need to convert your accounts at the end of the year, as must be done with organizations using a cash basis accounting system. The conversion of a cash-based system is generally done at the end of the fiscal year as part of the annual audit. At this time, an accountant takes all the payables and receivables and factors them into the financial statements, thus allowing the organization to show its entire financial operation on an accrual basis. It should be pointed out that this practice (presenting the year-end financial statement on an accrual basis) is one of the “generally accepted accounting principles” recognized by the accounting profession.
Functional Classification of Expenses

Your final budget provides you with the basis for allocating costs and revenues to different organizational activities or programs (sometimes also called cost objectives) within your accounting system. This sometimes is called functional program accounting, or “cost” accounting, and is a method that allows organizations to track their financial resources according to various programs or functions they undertake. In this method, each program or activity becomes its own budget unit, with its own categories of expenses. Once separate accounts are established for each cost objective, the total expenses in all accounts become the total expenses of the organization. It is suggested that the following program accounts (paralleling the same cost objectives or functional areas as contained in your budget) be established:

Management and General Expense Account: Generally, these accounts track the administrative and management functions of the organization, as opposed to its direct conduct of fundraising activities or program services. Overall management usually includes the salaries and expenses of the executive director of the organization, however if part of their time is spent in providing program services and fundraising activities, their salaries and expenses should be allocated among those functions. Other Management and General expenses include office rent and utilities, telephone, supplies, general legal services, accounting and billing, general Liability insurance, auditing, and so forth. Only costs related to the administrative activities of the overall organization should be allocated to “M & G”.

Program Services or Projects Expense Accounts: As many accounts as necessary to accommodate separate and distinct programs or project activities should be established. Any monies received, expended, held or owned by the organization in connection with these programs or projects should be allocated to these accounts. For instance, if your organization is under contract to provide the administration for a countywide housing rehabilitation program, this program should have its own expense account within your accounting system (this does not mean its own separate bank account, which will be discussed in more detail later). Or if your organization is undertaking the HOME-funded construction of single family homes for sale to first time homebuyers, expenses related to this activity should be accounted for separately.

Fundraising Expense Account. Any monies allocated or expended by an organization in conjunction with fundraising should be classified separately. Fundraising activities include publicizing and conducting fund-raising campaigns; maintaining donor mailing lists; conducting special fund-raising events, and conducting other activities involved with soliciting contributions from individuals, foundations, government agencies, and others. These activities would include staff time and other costs devoted to writing grant applications or other activities to obtain federal, state, or other types of funding for operating.
Important, different cost objectives or budget units should be numbered and this number used as a prefix (or extension) on the chart of accounts numbers you have established for Expenditures. For instance, if you have assigned the number 7000 to salaries and the number 3 (or 03) to your “Management and General” budget unit, salaries for staff working on activities within this cost objective (overall organizational operations) could be coded as 3-7000. It should be emphasized that you can choose whatever numbering system you want (for instance, you could use numbers in the hundreds rather than the thousands), but you must be consistent once you establish your numbering system (chart of accounts).

**Accounts in an Accounting System**

Accounting systems are made up of accounts that have dollar amounts assigned to them and represent economic units. All accounts are classified under one of five account groups. Three of the account groups, called real accounts, are Assets, Liabilities, and Net Assets. These groups are called “real accounts” because they are permanent, namely their balances are carried over from year to year. Revenue and expenditures, the other two types of accounts, are called nominal accounts because they are used for one year, or budget period, after which they are closed to a zero balance and then opened as new accounts in the new year or operating period.

**ASSETS**

Assets are: (1) what an organization owns or what it is owed and (2) needed to conduct the daily operations of the organization and are expected to provide future economic benefit to it. Examples of Asset Accounts are:

- Cash in bank (checking and savings)
- Petty Cash
- Accounts Receivable
- Notes Receivable
- Grants Receivable
- Prepaid Insurance
- Equipment
- Buildings
- Land
- Furniture, Fixtures, and Equipment
- Vehicles
- Construction in Progress
- Refundable Deposits
- Bonds and other investments

Current Assets indicate Assets that can be converted into cash within a relatively short period of time (generally, within one fiscal year) without disrupting the normal operations of an
organization. This would include such things as cash accounts, accounts (or grants) receivable, and inventory. Long-term Assets (also called fixed Assets) represent such items as stocks and bonds, as well as buildings and equipment. For example, if an organization owns its own office building, that building is needed to conduct the daily operations of the organization and is expected to provide future economic benefit to the organization (if sold).

In some cases, an organization may prefer to show its land, buildings, and equipment holdings separately from its other fixed Assets. It is important to mention here, however, that depreciation of Assets is a factor here. The depreciation of an Asset is a way of allocating the cost of an Asset, such as a building or equipment, over a period of time. When this is done, the amount shown for an Asset minus depreciation does not represent the market value of the Asset but the “book value” (original cost minus charges against that cost for use over time).

**LIABILITIES**

Liabilities represent the debts of an organization, or what it owes. When merchandise, a loan, a mortgage, or a service is received (obtained) and not paid for, an organization has a debt to pay. This debt is called a Liability. Debts, however, are not the same as expenses. When an expense is incurred but not paid, a Liability is created. When an expense is paid a Liability is not created. Liabilities are grouped into two categories: current Liabilities and long-term Liabilities. Examples of Liability Accounts are:

- Accounts payable
- Accrued Expenses – i.e., payroll, payroll taxes, personal property or real estate taxes
- Other unearned and deferred revenue
- Refundable advances
- Short term notes and loans payable
- Mortgages payable
- Control accounts for contracts
- Obligations under capital leases

Current Liabilities are debts that will be paid within the fiscal year, such as accrued payroll and rent, utilities, merchandise bought on a credit agreement, etc. Long-term Liabilities are those that extend beyond the current fiscal year, such as a twenty-year mortgage or five-year bonds. It is important to note how the management of Liabilities can impact an organization’s budget. For example, when a service is received, but not paid for on time, carrying charges or interest charges are often added to the price. These amounts are an additional expense to the organization but do not add to its overall worth.
NET ASSETS

As described earlier, Net Assets are often defined by the following formula:

\[
\text{Assets} = \text{Liabilities} + \text{Net Assets} \quad \text{or} \quad \text{Assets} - \text{Liabilities} = \text{Net Assets}
\]

This formula means that if Liabilities are greater than Assets, the organization will have a negative Net Asset account. Examples of Net Asset Accounts are:

- **Unrestricted:**
  - Available for general activities
  - Board designated for special purposes
  - Land held for use, not investment - Net
  - Buildings - held for use, not investment - Net
  - Building and leasehold improvements - Net
  - Furniture and Equipment - Net

- **Temporarily Restricted:**
  - Control accounts for grants restricted for program
  - Control accounts for grants restricted for fixed Asset acquisition
  - Control accounts for time-restricted grants

- **Permanently Restricted:** Endowments

REVENUES

In essence, Revenue Accounts capture the information on what your organization receives. Examples of Revenue Accounts are:

- **Direct Contributions from:**
  - Individuals and small businesses (donations)
  - Fundraising (gift portion)

- **Donated services or use of facilities**

- **Other gifts in kind**

- **Corporate and other business grants**

- **Foundation Grants**

- **Government Grants (equivalent to contributions): Federal, state, and other**

- **Revenue from fees**

- **Contracts or fees from government agencies: Federal, state, local, and other**

- **Revenue from Investments:**
  - Interest from savings and temporary cash investment
- Dividends and Interest from securities
- Gross rents

Revenue from other sources:
- Net amount from sale of other Assets (Sales of other Assets less cost and sale expense)
- Other cost and sales expense
- Unrealized gain (loss) on value of other Assets
- Net sales to public – (Sales to public less Cost of Goods Sold)

Net Assets Released from Restriction

**EXPENSES**

Under accrual-based accounting, an item becomes an expense when its cost is incurred or paid for. Prior to payment, these costs, as accrued, are also Liabilities. Expenses are the same as line items contained in your organization’s budget, such things as:

- Salaries and Related Expenses
- Other Expenses, such as:
  - Program costs (for instance, rehabilitation, construction, acquisition costs, downpayment assistance, or second mortgage assistance for housing programs)
  - Accounting, Legal and Other professional fees
  - Donated professional services
  - Supplies
  - Donated materials and supplies
  - Phone
  - Postage
  - Rent and Utilities
  - Donated use of facilities and utilities
  - Maintenance and Repair
  - Printing
  - Travel
  - Depreciation
  - Insurance
  - Membership dues
  - Contingency
  - Capital purchases: land, building, equipment, vehicles (until end of year when moved to Assets)

As stated previously, Assets and Liability Accounts go together, as opposite sides of a balanced equation (with Net Assets). In a similar way, revenues (what’s coming in) and expenditures (what’s going out) go together.
Double-entry Accounting: using Debits and Credits

The following explanation of double-entry accounting and debits and credits is adapted from “Accounting and Budgeting in Public and Nonprofit Organizations: A Manager’s Guide” by William C. Garner.

For organizations using computer-based accounting, double entry accounting is automatically carried out. It is important, however, to understand the underlying concept of a double-entry accounting system. “Double-entry accounting”, or dual-entry accounting (as opposed to single-entry accounting or the “checkbook” method) is fundamental to protecting the resources and revenue of an organization. Double-entry accounting, which is carried out through bookkeeping entries, is a self-balancing accounting method that dramatically reduces the chances of accounting errors.

The basic core of this accounting system is debits and credits, two types of activities that can affect any financial account of any type: Assets, Liabilities, Net Assets, revenues and expenditures. Under dual-entry accounting, each “transaction” is entered into the accounting system twice—as one or more credits and again as one or more debits. This means that for each debit (or credit) entry, there must be an equal amount of credit (or debit) entered in order for the accounting formula to balance.

Remember the formula? It was Assets = Liabilities + Net Assets.

One common misperception of the definition of credits and debits is that “credit” always means to increase and “debit” always means to decrease. In dual entry accounting, “credit” sometimes means to increase an account and “debit” sometimes means to decrease an account (and other times it means the opposite). Another misperception is that if you are decreasing one account (through a debit or a credit), you must be increasing another account. However, because of how debits and credits affect different types of accounts, this is also not always the case. In fact, as you will see, a transaction entered with the dual entry accounting method can increase both accounts affected. Confused? Read on.

In order to describe how the double-entry method and credits and debits work, it is first helpful to describe what is called the “T Account” diagram (an accounting invention). In the T Account diagram, the left side of the T always represents debits and the right side of the T always represents credits. In the accounting process, a dollar amount is recorded as a debit (left side) or as a credit (right side) depending on how that transaction affects that particular account. And, as stated previously, debits and credits affect different account types differently.
The Effect of Debits and Credits on Real Accounts

In what can seem contradictory, debits increase Asset accounts, and credits increase Liabilities and Net Asset accounts. Conversely, a credit decreases an Asset account, and a debit decreases Liability and Net Asset accounts. This is because Asset Accounts have a natural debit balance (or positive balance) and Liability and Net Asset Accounts have a natural credit balance (or negative balance). The following T diagrams display this:

<table>
<thead>
<tr>
<th>Asset Accounts</th>
<th>Liabilities and Net Assets Accounts</th>
</tr>
</thead>
<tbody>
<tr>
<td>Increases balance</td>
<td>Decreases balance</td>
</tr>
<tr>
<td>Balance Side</td>
<td>Balance Side</td>
</tr>
<tr>
<td>(debit)</td>
<td>(credit)</td>
</tr>
<tr>
<td>(debit)</td>
<td>(credit)</td>
</tr>
</tbody>
</table>

This T diagram shows it another way:

<table>
<thead>
<tr>
<th>Debit Balance Side</th>
<th>Credit Balance Side</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debits (+ Assets)</td>
<td>Debits (- Liabilities and Net Assets)</td>
</tr>
<tr>
<td>Credits (- Assets)</td>
<td>Credits (+ Liabilities and Net Assets)</td>
</tr>
</tbody>
</table>

The effect of debits and credits on the real accounts can also be summarized as follows:

<table>
<thead>
<tr>
<th>Debits</th>
<th>Credits</th>
</tr>
</thead>
<tbody>
<tr>
<td>Increase an Asset account</td>
<td>Increase a Liability account</td>
</tr>
<tr>
<td>Decrease a Liability account</td>
<td>Increase a Net Asset account</td>
</tr>
<tr>
<td>Decrease a Net Asset account</td>
<td>Decrease an Asset account</td>
</tr>
</tbody>
</table>

The Effect of Debits and Credits on Nominal Accounts

One common problem in trying to understand the effect of debits and credits on nominal accounts is to try to relate expenditures to Liabilities and revenues to Assets. This, however, is not the case. Rather, expenses and revenues should be perceived in relation to Net Assets: expenses lower the Net Assets and revenues increase them. Because of this relationship to Net Assets, revenues have a credit balance like the Net Assets accounts, and expenses have a debit balance as they reduce Net Assets.
Consequently, when an expense is incurred and recorded, the expense account is debited, and when revenue is received, the revenue account is credited. The formula $A = L + NA$ is now modified as follows: $Assets + Expenses = Liabilities + Net Assets + Revenue$

Or $Assets = Liabilities + NA + Revenue(Income) - Expenses$

Or $Net Assets = Assets - Liabilities + Expenses - Revenue(Income)$

The following T accounts exhibit the application of debits and credits to expense and revenue accounts:

<table>
<thead>
<tr>
<th>Expenditure Accounts</th>
<th>Revenue Accounts</th>
</tr>
</thead>
<tbody>
<tr>
<td>Increases balance</td>
<td>Decreases balance</td>
</tr>
<tr>
<td>Balance Side (debit)</td>
<td>(credit)</td>
</tr>
<tr>
<td>Decreases balance</td>
<td>Increases balance</td>
</tr>
<tr>
<td>Balance Side (debit)</td>
<td>(credit)</td>
</tr>
</tbody>
</table>

This T diagram shows this in a different way:

<table>
<thead>
<tr>
<th>Debit Balance Side</th>
<th>Credit Balance Side</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debits (+ expenses)</td>
<td>Debits (- revenues)</td>
</tr>
<tr>
<td>Credits (- expenses)</td>
<td>Credits (+ revenues)</td>
</tr>
</tbody>
</table>

Therefore, the actions of debits and credits on accounts is extended as follows:

<table>
<thead>
<tr>
<th>Debits</th>
</tr>
</thead>
<tbody>
<tr>
<td>Increase an Asset account</td>
</tr>
<tr>
<td>Increase an expense account</td>
</tr>
<tr>
<td>Decrease a Liability account</td>
</tr>
<tr>
<td>Decrease a Net Asset account</td>
</tr>
<tr>
<td>Decrease a revenue account</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Credits</th>
</tr>
</thead>
<tbody>
<tr>
<td>Increase a Liability account</td>
</tr>
<tr>
<td>Increase a Net Asset account</td>
</tr>
<tr>
<td>Increase a revenue account</td>
</tr>
<tr>
<td>Decrease an Asset account</td>
</tr>
<tr>
<td>Decrease an expense account</td>
</tr>
</tbody>
</table>

In other words, debits have the effect of increasing Assets and decreasing Liabilities, while increasing Expenditures and decreasing Revenues. Credits have the effect of decreasing Assets and increasing Liabilities while decreasing Expenditures and increasing Revenues. While this seems to make perfect sense with Revenues and Expenditures (i.e., a debit, such as paying a bill, reduces Revenues and a credit, such as a contribution, increases Revenues), it
appears to be totally “wrong” with respect to Assets and Liabilities. Why would a credit, decrease an organization’s Assets? Confused? The following examples may help explain:

- Let’s say your organization borrows $20,000. In this transaction, cash (an Asset) is debited (increased) and Notes Payable (a Liability) is credited (also increased). In other words, with this transaction, you have increased your organization’s Assets (cash) but also increased its Liabilities (notes payable). An accountant would record this transaction like this:

<table>
<thead>
<tr>
<th>Cash (Asset)</th>
<th>Notes Payable (Liability)</th>
</tr>
</thead>
<tbody>
<tr>
<td>$20,000</td>
<td>$20,000</td>
</tr>
<tr>
<td>(debit)</td>
<td>(credit)</td>
</tr>
<tr>
<td></td>
<td>(debit)</td>
</tr>
</tbody>
</table>

- What if your organization sells a single-family home that you have constructed to a first time homebuyer? Land and Buildings (an Asset account) is credited (decreased), Cash (an Asset) is debited (increased) and Gain from Sale (an income account) is credited or increased. In this instance, it is assumed that you sold the home for $15,000 more than it cost to built it (including land), so there is need for three entries in order for the formula to balance ($95,000 in credits and $95,000 in debits). An accountant would record this transaction like this:

<table>
<thead>
<tr>
<th>Land and Buildings (Asset)</th>
<th>Cash (Asset)</th>
</tr>
</thead>
<tbody>
<tr>
<td>$80,000</td>
<td>$95,000</td>
</tr>
<tr>
<td>(debit)</td>
<td>(credit)</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>Gain from Sale (Income)</td>
<td></td>
</tr>
<tr>
<td>$15,000</td>
<td></td>
</tr>
<tr>
<td>(debit)</td>
<td>(credit)</td>
</tr>
</tbody>
</table>

- Let’s say you pay your monthly office rent bill by the first of the month. Your Office Rent Account (an expense account) is debited (increased) and Cash (an Asset) is credited (decreased). An accountant would record this transaction like this:

<table>
<thead>
<tr>
<th>Office Rent (Expense)</th>
<th>Cash (Asset)</th>
</tr>
</thead>
<tbody>
<tr>
<td>$350</td>
<td>$350</td>
</tr>
<tr>
<td>(debit)</td>
<td>(credit)</td>
</tr>
</tbody>
</table>
One thing to remember about credits and debits is that in the dual entry system, they must always go together. For every credit there is one or more equivalent debit and for every debit there is one or more equal credits.

- Here's another example: Your organization gets notification of an operational grant for $30,000 from the State (award is for the same time period as your fiscal year). Your accountant would record this award as follows:

<table>
<thead>
<tr>
<th>Grants Receivable (Asset)</th>
<th>Grants (Revenue)</th>
</tr>
</thead>
<tbody>
<tr>
<td>$30,000</td>
<td>$30,000</td>
</tr>
<tr>
<td>(debit)</td>
<td>(debit)</td>
</tr>
<tr>
<td>(credit)</td>
<td>(credit)</td>
</tr>
</tbody>
</table>

The award is posted to Grants Receivable as a debit because that account is an Asset and debits increase Assets. The amount is also posted to “Grants” as a credit, because credits increase revenue accounts. When you receive the check from the State, accounts are changed as follows:

<table>
<thead>
<tr>
<th>Cash (Asset)</th>
<th>Grants Receivable (Asset)</th>
</tr>
</thead>
<tbody>
<tr>
<td>$30,000</td>
<td>$30,000</td>
</tr>
<tr>
<td>(debit)</td>
<td>(debit)</td>
</tr>
<tr>
<td>(credit)</td>
<td>(credit)</td>
</tr>
</tbody>
</table>

Your accountant will record the transaction like this because Cash and Grants Receivable are both Assets: a debit increases the former and a credit decreases the latter (a balance).

- Let’s say that a local lender decides to meet its CRA obligations and mails you a $1,000 contribution. This transaction (without prior notification) would look like this:

<table>
<thead>
<tr>
<th>Cash (Asset)</th>
<th>Contributions (Revenue)</th>
</tr>
</thead>
<tbody>
<tr>
<td>$1,000</td>
<td>$1,000</td>
</tr>
<tr>
<td>(debit)</td>
<td>(debit)</td>
</tr>
<tr>
<td>(credit)</td>
<td>(credit)</td>
</tr>
</tbody>
</table>

Applying the principles of debits and credits does complicate the accounting process. It is, however, necessary to providing checks and balances that will protect your organization’s finances.
Chart of Accounts

Although the Chart of Accounts was described in “Part II. Budgeting”, it is important again to describe its role, especially with respect to the accounting system. A Chart of Accounts provides the backbone of an accounting system and the reports it generates. It provides the structure for the general ledger, from which a period-ending trial balance is prepared (discussed later).

As explained earlier, a chart of accounts is a system for identifying and classifying accounts and transactions by the type of account or the nature of the transaction (that is, what occurred) and by the activity or function involved (that is, the purpose for which the transaction occurred).

The exact numbering of a Chart of Accounts can vary from organization to organization. However, accounts are always ranked in the same ascending order: Assets first, followed by Liabilities, Net Assets, Revenues, and Expenses. One example of a “Chart of Accounts” takes the following sequence:

- **Asset and Liability and Net Asset Accounts**
  - 1000's Assets (“Cash” is generally given the first number)
  - 2000's Liabilities
  - 3000's Net Assets

- **Revenue and Expense Accounts**
  - 4000's Revenue
  - 5000's Cost of Goods Sold (Expense)
  - 6000-9000's Expense

At this time, it is also important to describe a contra account. Contra accounts have the effect of decreasing (or “contradicting”) a particular account. For this reason, contra accounts are given a number in the series immediately following the account it affects. An example of a contra account would be “accumulated depreciation” under “fixed Assets” (Asset account) or “cost of goods sold”, deducted from “Gross Sales” (Revenue Account).

Finally, two important points should be noted. First, your Chart of Account numbers for Revenues and Expenses should be the same as those contained in your budget. Second, the numbers assigned to accounts should allow for new accounts to be added.
The Accounting System in Action

When an organization enters into a business transaction, the primary concern is that the transaction is entered into the system properly. This requires a record of the transaction (such as an invoice, contract, memo for a budget amendment, etc.) is available for the entry into the system and that this record then be kept on file. This record is called the source document and will be discussed further in the following Chapter on Internal Controls. The accurate and timely entry of all transactions will ensure that the organization can be kept up-to-date of the status of individual transactions as well as on its financial condition overall and with respect to each cost center or functional account.

Points of Entry

Much of the raw data that will be entered into your accounting system will consist of business transactions that result in either a deposit into your bank account or a withdrawal from your account. These transactions—depositing money and paying bills—and the internal controls needed to manage these processes are discussed in detail in Part IV. The following description assumes that these processes have been carried out according to proper procedures and that it is now time to enter these transactions into the accounting system.

In a computerized accrual based accounting system, there are five points of entry into the system. These are the “Accounts Receivable” and “Accounts Payable” subledgers, the “Cash Receipts” and “Cash Disbursements” journals, and a “general” journal for entering adjusting journal entries that do not fit the other four categories. The totals in these subledgers and journals agree with the control accounts in the General Ledger (see the following section). Because entries into the subledgers and journals establish the business diary of an organization, they should be made as often as necessary, even daily.

Some of the entries into a subledger or journal may be automatically recorded by a bookkeeper, while others may need to be authorized before an entry can be recorded. Additionally, for auditing purposes it is critical that subledger entries adhere to the following:

- The entries are in chronological order
- The correct name of the account is debited
- The correct name of the account is credited.
- An explanation for the entry is included.
- If appropriate, a source document number is included with the explanation.
**Accounts Receivable**

The “Accounts Receivable” subledger is an important part of an accrual based accounting system and lists money owed or due to an organization. It is important to understand that because Accounts Receivable indicates monies that will be received, it is almost like cash in the bank. For this reason, entries to Accounts Receivable show up as an Asset to an organization. An entry into the Accounts Receivable subledger should be made only when official notification of funding is received.

**Accounts Payable**

“Accounts Payable” is the subledger that is a list of all monies owed by an organization. For this reason, Accounts Payable appear as a Liability to an organization. This means that entries to Accounts Payable must credit a Liability account and debit the appropriate expense accounts. Accounts Payable is another ledger that only exists in an accrual-based system, and entries into this subledger should be made only when an invoice (bill for services or goods) is presented or expenses are accrued. In a cash-basis system there would be no subledger of this type.

**Cash Receipts**

The Cash Receipts journal is used to record all cash and checks your organization receives and should be used to back up the information that appears on an organization’s regular bank deposit statements. Cash Receipts entries would appear as a credit to the appropriate revenue account, with the corresponding debit (increase) in an Asset Account.

**Cash Disbursements**

The Cash Disbursements journal records all checks that an organization writes. The Cash Disbursements journal follows your checking account (checkbook) entries and would all appear as a credit to your Cash (Asset) account. The corresponding debit within the system, however, may appear in any number of accounts, depending on the transaction. For instance, payment of salaries would appear as a debit to an expense account (salaries). Another example would be a purchase of a piece of equipment, which would appear as a credit to Cash (Asset), and a debit to the Equipment (also Asset) account. The Cash Disbursements journal is also used to record petty cash and other cash needs (for instance, a trip to the post office to buy stamps).

**The General Journal**

The General Journal is used to record entries in the system that do not fit into any of the above categories. An example of a “transaction” entered through the General Journal would be adjustments to Fixed Assets for depreciation, adjustments to accounts when the books are reconciled at the end of the year, or adjustments for bank charges on automatic withdrawals.
**Entering Transactions, Some Examples:**

**Example 1:** Your organization has signed a $3,200 contract with a planning consultant to complete a market study for a housing project you are considering. When the contract is fulfilled and a completed market study and invoice is delivered to the organization, the amount is entered into the “Accounts Payable” subledger under the appropriate Liability and Expense accounts. The source document for these entries is the invoice from the consultant (and the completed market study), and no authorization for the entries is needed before a check can be drawn. The invoice is the backup source document for the entries and the check. When a check is prepared and sent, an entry is made in the Cash Disbursements journal to essentially remove the liability and credit (reduce) “Cash”. These transactions would look like this:

<table>
<thead>
<tr>
<th>Date</th>
<th>Description</th>
<th>Posting Reference</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mar 21, 2001</td>
<td>Professional Services (Project A Expense Account)</td>
<td></td>
<td>$3,200</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Accounts Payable (Liability Account)</td>
<td></td>
<td></td>
<td>$3,200</td>
</tr>
<tr>
<td></td>
<td>Invoice from City Consulting (###) for Market Study</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Date</th>
<th>Description</th>
<th>Posting Reference</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mar 30, 2001</td>
<td>Accounts Payable (Liability Account)</td>
<td></td>
<td>$3,200</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Cash (Asset Account)</td>
<td></td>
<td></td>
<td>$3,200</td>
</tr>
<tr>
<td></td>
<td>Check # XXXXXX Final payment to City Consulting</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Example 2:** The local Chamber of Commerce allows you to use some of its excess office space free-of-charge. This donation has an equivalent fair market value of $1,000 per month. To record this transaction, an entry is made into the general journal recording the transaction as a debit to your office rent expense account and a credit to revenue from “In-Kind Donations”. Each month, as long as this arrangement is in place, a general journal entry like this would be made.

<table>
<thead>
<tr>
<th>Date</th>
<th>Description</th>
<th>Posting Reference</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jan 31, 2002</td>
<td>Office Rent (Mgt. and Gen. Expense Account)</td>
<td></td>
<td>$1,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>In-Kind Donations (Revenue Account)</td>
<td></td>
<td></td>
<td>$1,000</td>
</tr>
<tr>
<td></td>
<td>Memorandum of Understanding with Chamber</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Example 3:** Your organization purchases Director’s and Officer’s Insurance for its Board and Executive Director. The policy, which must be prepaid, costs $2,400 annually. Upon receipt of the bill, the transaction would be entered in the Accounts Payable subledger as a credit to Accounts Payable and a debit to “Prepaid Insurance”. As in Example 1, upon payment of the bill (issuance of a check for the insurance), an entry in the Cash Disbursements journal is
made to debit (decrease) Accounts Payable and credit (decrease) “Cash”. However, because prepaid insurance premiums are considered an Asset, an entry would be made at the end of each month in your General Journal to debit your D & O Insurance account and credit (reduce) your prepaid insurance (Asset account) by the amount of insurance “used up” each month, $200.

<table>
<thead>
<tr>
<th>Date</th>
<th>Description</th>
<th>Posting Reference</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nov 30, 2001</td>
<td>D &amp; O Insurance (Asset Account)</td>
<td></td>
<td>$2,400</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Accounts Payable (Liability Account)</td>
<td></td>
<td></td>
<td>$2,400</td>
</tr>
<tr>
<td></td>
<td>Billing Statement from Insurance Company</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Date</th>
<th>Description</th>
<th>Posting Reference</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dec 29, 2001</td>
<td>Accounts Payable (Liability Account)</td>
<td></td>
<td>$2,400</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Cash (Asset Account)</td>
<td></td>
<td></td>
<td>$2,400</td>
</tr>
<tr>
<td></td>
<td>Check # XXXXXX Payment for Insurance 1/1-12/31, 2002</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Date</th>
<th>Description</th>
<th>Posting Reference</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Each Month in 2002</td>
<td>D &amp; O Insurance (Mgt. &amp; Gen. Expense Account)</td>
<td></td>
<td>$200</td>
<td>$200</td>
</tr>
<tr>
<td></td>
<td>Prepaid Insurance (Asset Account)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Insurance prorated by month</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**The General Ledger**

The general ledger is the heart of an accounting system. All entries recorded in subledgers and journals feed into the general ledger and no financial transaction should occur without passing through its “pages”. It constitutes the history of an organization’s financial transactions. The General Ledger is the summarization of all subledger and journal entries, and thus, all receipts, invoices, and other paperwork known as “source documents” that support the transactions recorded within it. An organization’s financial statements are built from the General Ledger.

The General Ledger interacts with other parts of an accounting system through a process called “posting”. Posting is simply entering into the General Ledger a summary of transactions recorded in the subledgers or journals, with a reference number (i.e., check number, general journal entry number, subledger code). In a computerized accounting system, posting to a subledger will automatically post the subledger balance to the General Ledger. In the posting process, each debit or credit in a journal is transferred to the appropriate account in the ledger (i.e., salaries, payroll taxes, professional fees, etc. by each functional area such as Management and General, Fund Raising, Project A, Program B, etc.).
The General Ledger mirrors an organization’s financial statements. Generally, it looks like the Statement of Financial Position (Assets, Liabilities, and Net Assets) and the Statement of Activities (Revenues and Expenditures).

**The Trial Balance: Debits = Credits**

The Trial Balance is a test run for the balances of the accounts that appear in the General Ledger and consequently, a tool used to detect errors in accounting records. It is an internal working document that is prepared monthly, along with the budget reports (see Part II). The accounts on the trial balance are arranged as they appear in the General Ledger — in other words, by account number: Assets (and any contra accounts), followed by Liabilities, Net Assets, Revenues, and Expenses.

The trial balance has two columns: debits and credits. A trial balance lists the debit and credit balances for each account (i.e., cash in bank, accounts payable, grants receivable) in the General Ledger. The totals of the debit and credit balances on the trial balance must always be equal; if they are not equal, an error has been made. An amount may be incorrect, or the wrong account may have been debited or credited. A sample trial balance sheet is shown on the following page.

After running a trial balance, the subledger balances are checked against the balance in the control accounts (Accounts Receivable and Accounts Payable) in the General Ledger to ensure that they agree. The trial balance provides the information necessary to prepare the financial statements and budget reports.
### ABC Nonprofit Trial Balance as of May 31, 2002

<table>
<thead>
<tr>
<th>COA #</th>
<th>Debits</th>
<th>Credits</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash in Bank – operating</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash in Bank – payroll</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Petty Cash</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Grants Receivable</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accounts Payable</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accrued Expenses - salaries</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accrued Expenses - payroll taxes</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Unrestricted Net Assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Temporarily Restricted Net Assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Permanently Restricted Net Assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Contributions</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Grants – federal</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sale of Assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cost of sales</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Salaries and wages</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Employee benefits</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rent</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Utilities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Telephone</td>
<td></td>
<td></td>
</tr>
<tr>
<td>TOTAL</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### Closing the Books

At the end of the year or operating period, the books are closed, and the balances for the revenues and expenses are adjusted to zero by transferring the balances into the applicable Net Asset accounts. If the revenue account balances are greater than the total of the expense accounts, there is a positive impact on Net Assets. If the reverse is true, then the effect is negative.
Part IV. Internal Controls

An important part of the financial management of an organization is a system of internal controls. Technically, internal controls are mechanisms to protect an organization against theft or misuse (either intentional or unintentional) of monies or assets by employees, however, they also serve to protect an organization against the appearance that internal theft is possible. This makes internal controls important in protecting an organization’s reputation and image in the community.

Internal controls are generally thought of as fiscal (record keeping and accounting) policies and procedures. However, the term “internal controls” is easily expanded to include much more. Other areas for internal control (to safeguard assets or, theoretically, the continued existence of an organization) include organizational policies on inventory and equipment, bonding and insurance, personnel, computer security, and payroll. But before we turn to these non-accounting areas, let’s look at internal controls for fiscal and accounting procedures.

Internal Control of Fiscal and Accounting Procedures

Internal controls in the fiscal area generally address how money will be handled within the organization to ensure that it will be safely received, recorded, and deposited, and then expended in an appropriate manner. Instituting internal controls results in timely and accurate recording, reconciling, and summarizing of transactions into the accounting system, and ultimately, the financial statements of an organization.

Most fiscal controls are based on the premise that two people are far less likely to make a mistake, either intentionally or unintentionally, than one. This means that in a small organization, where the division of labor falls to only a very few people, internal controls are often difficult to apply.

In any organization, there are two primary areas where internal controls are needed: cash receipts and cash disbursements. It is in the area of cash receipts that internal controls are most difficult to follow in small organizations. Before describing internal controls in these areas, however, it is important to discuss the documentation required for all transactions. These are called “source documents”.

Source Documents

In order to properly manage and track all transactions of your organization, all data entered into the accounting system must have an accompanying “source document” or “back-up” documentation. Backup documentation consists of such things as purchase orders, invoices, memorandums, employee time sheets, check stubs, contracts, receipts, award letters,
organizational policies, etc. Each source document should be appropriately coded and approved, if necessary, before the information from it is entered into the system.

**Controls on Incoming Monies - Cash Receipts**

Where incoming monies are involved, the following procedure is recommended:

1. Mail is opened and date-stamped. The person who opens the mail records all incoming checks (or cash) by date, amount, source (payer), and restriction (if any) in a “receipts log”. This person should be someone with no other cash or accounting responsibilities in the organization.

2. Checks and cash are then forwarded to an employee who prepares a deposit slip and matches it against the entries in the receipts logs. Receipts are deposited that same day.

3. A copy of the deposit slip and daily receipt log are coded according to the approved chart of accounts, entered into the accounting records, and filed.

4. Periodically, someone other than these two people (board members work well here), should check to see that the two sets of records agree.

**Bank Deposits**

Your Cash Receipts ledger should include all information that appears on your regular bank deposit statements. A receipt should be issued for each transaction. Bank deposits should be made daily. Deposit slips should be made in duplicate, with a copy kept to assist in reconciling the bank account at the end of each month and for verification against the cash receipts journal. Deposits are reconciled to the general ledger cash account each month as part of the bank reconciliation process.

**Contributions**

Using information contained in the receipts log, contribution acknowledgments (and a thank you) should be sent to individual contributors that could seek a tax-deduction for their contribution. While individual contributors of $250 or more must receive a written acknowledgment in order to claim a deduction, it is good policy to acknowledge all contributions. Acknowledgements should include the amount and restrictions placed on the contribution by a contributor, if any, and contributors should be encouraged to contact the organization if amounts and restrictions are not reflected accurately. In addition to this, the relative deductibility of a contribution must be noted on acknowledgment letters. For instance, general contributions to a 501(c)(3) organization are 100% deductible as long as the contributor received nothing in return, like a coffee mug or similar item, for the contribution. If the contributor did receive something (called a quid pro quo donation), the fair value of this item must be deducted from the contribution. Copies of all acknowledgment letters should be maintained on file.
Controls on Outgoing Monies – Cash Disbursements

Processing Payments

As with cash receipts, there should be two people involved in processing all payments. One person should be someone who is familiar with the budget, the organization’s operation, and the appropriateness of specific expenditures. This person approves all payments and is most likely the director of the organization. The other person should be someone who writes the checks and monitors the expenditures for the board. (In a small organization, this could be the treasurer of the board.) If the director stays within the limits established by the budget, or the limits beyond the budget but set by the board, a check can be written. If the director requests payments that exceed these limits, the matter must be referred to the treasurer, the finance committee, or the full board for approval or for an amended budget.

There is a simple method for documenting the processing of payments. As suggested by Garner, every organization should invest in a rubber stamp with the following designation:

- Date Received:
- Account: (from Chart of Accounts)
- Check Number:
- Date Paid:
- Approved: (Signature)

Every invoice (this can also apply to other types of source documents, such as timesheets), before it is paid, gets stamped. (If the invoice arrives by mail, the person that opens the mail would stamp and fill in the “Date Received” line. If the invoice accompanies a delivery, the person accepting the delivery would do the same, etc.) If no invoice or other type of source document exists for a particular item, a document that describes the item being purchased or paid for with appropriate authorization should be prepared and stamped.

- The executive director (or whoever is responsible for approving invoices) fills out the first, second, and bottom lines. The first line indicates the date the invoice was received, the second indicates the account or line item that the expense gets charged to, and the final line allows the director to indicate his or her approval of the payment with a signature.

- The person responsible for writing the checks fills out the third and fourth lines after making sure that there is enough money remaining in the budget account to pay the bill.

- The person who signs the checks should be provided with all source documents for their review before signing.

After the completion of the transaction, the invoice (or other source document) is placed in a file so that an auditor can review the paper trail backing up the particular payment. Every disbursement must be properly supported by documents showing evidence of receipt and
approval of the related goods and services. For organizations with a fairly heavy volume of transactions, it is recommended that there be a separate file for each account.

In addition to protecting the organization from real or perceived fraud or abuse, good control over cash disbursements also avoids making duplicate payments and missing payment dates that allow prompt-payment discounts (or result in late fees). So it’s a money saving process no matter how you look at it!

**Petty Cash**

A petty cash fund is just what its name says—“petty”, that is of minor significance. Despite its small size, it is important to institute internal controls over petty cash. Petty cash accounts are necessary for immediate cash needs where following the internal controls set up for the check writing procedures are impractical. Petty cash should be kept in a secure place and at a level that requires neither excessive amounts on hand nor frequent replenishment. Most nonprofits find that $50 to $250 is a reasonable amount of petty cash to have on hand.

The most common way that a petty cash fund is administered is by an imprest system. In this system, a petty cash fund is established for a set amount (say $100), then reimbursed periodically to return the balance to that amount. The amount of cash plus any unreimbursed invoices should always equal $100. Typically, one person is responsible for distributing petty cash. Another person is responsible for monitoring the balance.

One system for managing petty cash is for the employee to complete a voucher indicating the amount taken from the fund, the purpose and date. (Vouchers are kept in the Petty Cash Fund “box”.) When the cash is used, a receipt for the purchase is stapled to the voucher and the exact amount recorded in a log (see example below). Documentation (i.e., receipts, etc.) for any petty cash disbursement should be kept in the Petty Cash box until the fund is replenished, then the documentation should be removed and filed with an organization’s other invoices. When the fund is reimbursed, the total of the amounts documented for disbursement should equal the difference between the original amount and the current balance (money in the Fund). In other words, the paper trail should cover the spent cash.

<table>
<thead>
<tr>
<th>Petty Cash Expense Reimbursement Report</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost</td>
</tr>
<tr>
<td>------</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Total Cost of Purchases</td>
</tr>
<tr>
<td>+ Cash on Hand</td>
</tr>
<tr>
<td>- Authorized Petty Cash Fund Amount</td>
</tr>
<tr>
<td>Difference (-) or (+)</td>
</tr>
</tbody>
</table>
Payroll

Payroll and fringe benefit costs are generally the most significant types of organizational expenditures for housing and service nonprofits. In many cases, salaries, benefits, payroll taxes, and so on, for employees can account for over 50% of an organization’s total expenses. Non-profit organizations must maintain reliable time records for each employee and each pay period, and the payment of salaries and wages must be based on documented payrolls.

A time sheet should be prepared and signed every payroll period for every employee. Even if the activity assignments are the same every payroll period, an organization needs a time sheet for its records. The time sheet is also needed to report any out-of-service time, such as vacation or sick leave. In cases where an employee is assigned to perform just one service, function or activity, 100% of the employee’s time, and therefore cost, is assigned to that service, function, or activity. All time sheets should signed by the employee and approved (also signed) by a supervisor (in the case of the Executive Director, this would be someone on the board).

When employees are assigned to perform more than one function, time reporting becomes even more essential. This is especially critical if salaries are being paid with federal funds. The proportion of salaries and wages charged to federal awards must be supported by time sheets or other personnel activity reports, unless a cost allocation system has been approved in writing by the awarding agency. For this reason, timesheets should be developed that accurately identify and code all activity areas that an employee may work in (i.e., Management and General, Project A, Program B, Fundraising, etc.). Federal requirements (see Part VI. Managing Federal Funds) state that:

“Charges to awards for salaries and wages, whether treated as direct costs or indirect costs, will be based on documented payrolls approved by a responsible official(s) of the organization. The distribution of salaries and wages to awards must be supported by personnel activity reports... maintained for all staff members whose compensation is charged, in whole or in part, directly to awards... Reports maintained by nonprofit organizations to satisfy these requirements must meet the following standards:

- The reports must reflect an after-the-fact determination of the actual activity of each employee. Budget estimates (i.e., estimates determined before the services are performed) do not qualify as support for charges to awards.
- Each report must account for the total activity for which employees are compensated. That is, the time sheet must be for 100%, not 150%, of an employees hours worked.
- The reports must be signed by the individual employee, and by a responsible supervisory official having first hand knowledge of the activities performed by the employee.
The reports must be prepared at least monthly and must coincide with one or more pay periods.

Charges for the salaries and wages of nonprofessional employees, in addition to the supporting documentation described above, must also be supported by records indicating the total number of hours worked each day.

Salaries and wages of employees used in meeting cost sharing or matching requirements on awards must be supported in the same manner.

All in-service, direct-staff salaries should be allocated based on direct-staff hours. This is critical to establishing cost allocations for indirect activities. When payroll-related expenses represent two-thirds or three-quarters of an organization’s budget, direct-staff salaries may be reliable as the primary basis for cost allocations.

Every payroll period, gross salaries and wages for each employee should be distributed to activities based on the percentage of time spent on each activity as evidenced by the time sheet for the related pay period. Year-to-date total direct-staff salaries should be maintained in the accounting system by activity.

**Other Controls on Cash Disbursements**

In addition to the internal control procedures identified in the preceding sections, there are a number of other controls or policies that should be established for cash disbursements. Among these are the following:

- The person in the organization who writes checks should not have “the power” to issue a check to himself or herself without at least a countersignature on the check. While banks probably will not monitor this, the policy can be recorded in the minutes of a board meeting and a person can be held in violation of a fiscal policy if the rule is not followed. One control that banks may be willing to monitor is that of requiring two signatures on all checks over a certain amount.

- To further monitor expenditures, use of checks made out to “cash” should be forbidden or severely restricted (see preceding discussion on “Petty Cash”).

- Vouchers and supporting documents should be appropriately canceled (stamped or perforated) to prevent duplicate payments.

- All check signers should be responsible officials or employees of the organization.

- Two signatures should be required on all check or on checks over a stated amount.

- Unissued checks should be kept in a secure area.

- Bank accounts must be reconciled monthly.
- Blank checks are never signed.
- Bank accounts and check-signers must be authorized by the board of directors.
- All checks should be pre-numbered and the check number should be recorded on the source document.
- Voided checks should be defaced and controlled for reconciliation purposes.
- The organization should have procedures that honor only those purchases made by people authorized by the board or by the board itself.

Ideally an organization will have only two types of cash accounts: a checking and a savings or money market account. It is much easier to monitor check writing and other financial activity if an organization does not maintain a large number of bank accounts. To the extent that it is feasible, all checks and deposits should be to one account (the checking account), with the second account serving solely to hold cash reserves or unexpended restricted funds. While it could be argued that more than one account is necessary to be sure that restricted funds are not used for other than their intended purpose, maintaining separate bank accounts can be time-consuming and even wasteful. This is especially the case if smaller amounts of cash that could earn interest if held in aggregate are held in several non interest-bearing accounts or if service changes are accruing on several accounts. From the point of view of controls, more accounts require more monitoring by an accountant when the books are audited.

- As with a policy to require board approval for all purchases over a specified dollar amount, an organization may also want to establish similar requirements for specific line items, such as equipment, contracts, or consultants.

- Nonprofits need procedures to ensure that they do not use federal funds for costs that are not allowed, or that the procurement of items which require approval of the awarding agency, has been approved in advance either in the award budget or as a special request to the awarding agency.

- Nonprofits should also have a conflict of interest policy that prohibits, or defines procedures for all transactions between the organization, its officers and directors, and their family members or companies.
Other Internal Control Measures

Insurance

Insurance, while not typically thought of as an internal control measure, fits this definition in its protection of an organization’s assets. One type of insurance, Workers Compensation Insurance, is required by state law. The other types of insurance are highly recommended as necessary for the prudent operation of an organization. Types of insurance include:

Workers Compensation Insurance: all businesses or organizations with employees are required by state law to have this type of insurance. Workers compensation provides payments to injured workers, without regard to who was at fault in the accident, for time lost from work and for medical and rehabilitation services. “Workers Comp” covers workers injured on the job, whether they’re hurt on the workplace premises or elsewhere, or in auto accidents while on business. It also provides death benefits to surviving spouses and dependents. The cost of Worker’s Compensation Insurance is based on the organization’s payroll and types of workers it employs (i.e., clerical, professional, construction, etc.)

Property Insurance: protects buildings and contents from loss due to circumstances such as fire or water damage. This type of policy does not cover vehicles, which must be covered under an automobile insurance policy.

General Liability Insurance: covers an organization’s legal responsibility for any “harm” it may cause to others. This “harm” is the result of things that the organization does or fails to do in its operations that may cause bodily injury or property damage. An example of this would be injury suffered by someone who falls down stair or trips over a hole in the carpet in your offices.

Directors and Officers Liability Insurance: provides for the recovery of losses in cases of breaches in Board members’ and officers’ (i.e., executive directors and other management personnel) fiduciary responsibilities. Nationally, more than 50% of the lawsuits brought against nonprofit organizations involve employees, with claims such as: discrimination due to race, sex, age, national origin, religion, disability, or sexual orientation; wrongful termination, sexual harassment, disputes on promotions and compensation; and hiring decisions, failure to supervise employees, and interference with employment contracts. Other types of claims include, but are not limited to: donors who feel that their contributions have not been used to further the mission of the organization; board members who disagree with a majority decision on the use of funds; beneficiaries who feel they are entitled to more than they received; and, mismanagement of funds (in legal proceedings instituted by State’s attorney generals).

While this type of insurance is optional, sometimes, knowledgeable community and business leaders will decline to join a board that has no such protections, because a claim like this can threaten the personal assets of directors, officers, and trustees. This type of insurance can be
quite expensive and approval for such a policy depends on the organization having a good financial track record, as well as financial statements that are in order.

Most importantly, however, an organization considering such insurance should make sure it knows exactly what is and isn’t covered by the policy. (One recommendation is to have the policy reviewed by an insurance professional other than the one selling it.) According to BoardSource, D & O Insurance does not cover fines and penalties imposed by law; libel and slander; personal profit; dishonesty; failure to procure or maintain insurance; bodily injury and property damage claims; and, suits by one board member against another. In other words, D & O Insurance will not cover an organization in instances of actual wrongdoing or failure to follow sound business practices.

**Bonding:** While bonding is not insurance, much like an insurance policy, it does protect an organization from financial losses—in this case, financial losses stemming from intentional (theft) irregularities in the handling of money. Bonding should not be viewed as a lack of trust of employees, but as a prudent internal control. Some funding sources require evidence of bonding before they will contribute dollars to a nonprofit organization.

In bonding, generally those people who handle money and sign checks are listed in the bonding document. Like insurance, a limit is placed on the amount an organization can collect in the case of a loss. The greater the limit, the greater the premium, however, bonding is relatively inexpensive. As a general rule of thumb, an organization should not use total annual expenses as the bonding limit figure even though at first glance this would seem to be prudent. The total budgeted dollars are rarely available to spend at any one time, and so it is unlikely that any loss would be so great. The organization should determine the maximum amount of money it anticipates having in the bank at any one time, increase the figure by 20%, and use that number as the bonding limit. Whether or not your organization decides on bonding, it is a comfort to both funders and trustees to know that such insurance against loss is in place.

**Physical Controls and Security Measures**

Physical controls such as fireproof and locking filing cabinets, fireproof safes, adequate locks on exterior, and if necessary, interior doors, and off-site storage of computer back-up disks or tapes provide additional protection for a responsible fiscal system.

**Personnel Files**

Files should contain:

- Job Description, title, responsibilities, requirements for position, chain of command (reports to), date hired
- Written authorizations covering rates of pay, withholdings, and deductions
Personnel Policies (see Appendix A.)

All organizations should establish personnel policies covering the following:

- Hiring Procedures
- Promotions
- Dismissals
- Vacation and Sick Leave
- Process for complaints

Record Retention

Every organization should have a formal record retention policy. These policies should include:

- Length of time to store records, based on type.
- Items older than set limits are destroyed
- Process for tracking records maintained in storage.

Property and Equipment

Nonprofits should avoid a lack of accountability for property and equipment, which can occur through:

- Lack of central equipment records;
- Failure to update such records, or to compare the records with periodic physical inventories of equipment; and
- Poor control over surplus equipment.

The following shows good control over property and equipment:

- There is an effective system of authorization and approval of capital equipment expenditure.
- Accounting practices for recording capital assets are written.
- Detailed records of individual capital assets are kept and are periodically balanced with the general ledger accounts.
- There are effective procedures for authorizing and accounting for disposal and transfers.
- Equipment and supplies are stored in a secure place.
# Internal Controls Checklist
*(developed by ICF Consulting for HUD)*

## Cash Receipts

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</thead>
<tbody>
<tr>
<td>1. Are checks endorsed “for deposit only” immediately upon receipt?</td>
<td>Yes</td>
<td>No</td>
<td>Not Sure</td>
<td>Not Applicable</td>
</tr>
<tr>
<td>2. Does someone prepare a daily list of all cash and checks immediately upon receipt?</td>
<td>Yes</td>
<td>No</td>
<td>Not Sure</td>
<td>Not Applicable</td>
</tr>
<tr>
<td>3. Are duplicate deposit slips and copies of checks retained in the files?</td>
<td>Yes</td>
<td>No</td>
<td>Not Sure</td>
<td>Not Applicable</td>
</tr>
<tr>
<td>4. Is the person who has custody of actual cash and checks different from the person recording them and acknowledging them in case of contributions?</td>
<td>Yes</td>
<td>No</td>
<td>Not Sure</td>
<td>Not Applicable</td>
</tr>
<tr>
<td>5. Are all cash and checks deposited intact and on a timely basis?</td>
<td>Yes</td>
<td>No</td>
<td>Not Sure</td>
<td>Not Applicable</td>
</tr>
<tr>
<td>6. Are restricted contributions clearly identified and recorded as restricted on the general ledger?</td>
<td>Yes</td>
<td>No</td>
<td>Not Sure</td>
<td>Not Applicable</td>
</tr>
<tr>
<td>7. Is all cash received, counted and verified by two employees?</td>
<td>Yes</td>
<td>No</td>
<td>Not Sure</td>
<td>Not Applicable</td>
</tr>
<tr>
<td>8. When events involve admission fees, does the agency issue pre-numbered tickets, with a record of tickets printed, issued, used and unused, which is then compared to funds deposited?</td>
<td>Yes</td>
<td>No</td>
<td>Not Sure</td>
<td>Not Applicable</td>
</tr>
<tr>
<td>9. Does the organization send acknowledgments to contributors and are copies of or record of such acknowledgments kept on file?</td>
<td>Yes</td>
<td>No</td>
<td>Not Sure</td>
<td>Not Applicable</td>
</tr>
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## Cash Disbursements

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<tbody>
<tr>
<td>10. Are all disbursements, except those from petty cash, made by pre-numbered checks?</td>
<td>Yes</td>
<td>No</td>
<td>Not Sure</td>
<td>Not Applicable</td>
</tr>
<tr>
<td>11. Are voided checks preserved and filed after appropriate mutilation?</td>
<td>Yes</td>
<td>No</td>
<td>Not Sure</td>
<td>Not Applicable</td>
</tr>
<tr>
<td>12. Is there a written prohibition against drawing checks payable to “cash”?</td>
<td>Yes</td>
<td>No</td>
<td>Not Sure</td>
<td>Not Applicable</td>
</tr>
<tr>
<td>13. Is there a written prohibition against signing checks in advance?</td>
<td>Yes</td>
<td>No</td>
<td>Not Sure</td>
<td>Not Applicable</td>
</tr>
</tbody>
</table>
14. Is a cash disbursement voucher prepared for each invoice or request for reimbursement that details the description of expense account to be charged and contains authorization signature and accompanying receipts and/or vendor invoices?  

15. Are all expenses approved in advance by authorized persons?  

16. Do the check signers review supporting documentation of expenses and approvals before signing checks?  

17. Are signed checks mailed promptly?  

18. Are paid invoices marked paid or attached to a copy of the check prior to filing?  

19. Are requests for reimbursement checked for mathematical accuracy and reasonableness before approval?  

20. Is check-signing authority vested in persons at appropriately high levels in the organization who do not have any accounting responsibility?  

21. Do checks require two signatures?  

22. Are bank statements and canceled checks received and reviewed by a person independent of the accounting functions?  

23. Are unpaid invoices maintained in an unpaid invoice file?  

24. Is a list of unpaid invoices regularly prepared and reviewed?  

25. If purchase orders are used, are all purchases supported by a pre-numbered purchase order?  

26. Are advance payments to vendors and/or employees recorded as receivables and controlled in a manner which assures that they will be offset against invoices or expense vouchers?  

27. Are employees required to submit expense reports for all travel related expenses on a timely basis?  

**Petty Cash**  

28. Is an imprest petty cash fund maintained for payment of small, incidental expenses?  

29. Does the organization follow a policy limiting the amount that can be reimbursed by the petty cash fund?
<table>
<thead>
<tr>
<th></th>
<th>Question</th>
<th>Yes</th>
<th>No</th>
<th>Not Sure</th>
<th>Not Applicable</th>
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</thead>
<tbody>
<tr>
<td>30</td>
<td>Is supporting documentation required for all petty cash disbursements?</td>
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<tr>
<td>31</td>
<td>Is a petty cash voucher filled out with supporting documentation, name of person being reimbursed, and proper authorization?</td>
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<tr>
<td>32</td>
<td>Is access to petty cash limited to one person who is the fund custodian?</td>
<td></td>
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<tr>
<td>33</td>
<td>Are unannounced counts of petty cash made by someone within the organization other than the fund custodian?</td>
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</table>

**Payroll**

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<tr>
<th></th>
<th>Question</th>
<th>Yes</th>
<th>No</th>
<th>Not Sure</th>
<th>Not Applicable</th>
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<tbody>
<tr>
<td>34</td>
<td>Are time sheets required documenting employee hours, overtime and what activity the employee worked on?</td>
<td></td>
<td></td>
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<tr>
<td>35</td>
<td>Are time sheets signed by employees and reviewed and signed by their immediate supervisors?</td>
<td></td>
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<tr>
<td>36</td>
<td>Are employment records maintained for each employee that detail wage rates, benefits, tax rates, and other pertinent information?</td>
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<tr>
<td>37</td>
<td>Are withheld employment taxes and employer taxes paid on a timely basis to the taxing authorities?</td>
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<tr>
<td>38</td>
<td>Do written policies and procedures exist for accounting for vacations, holidays, sick leave, and other benefits?</td>
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**Fixed Assets**

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<tr>
<th></th>
<th>Question</th>
<th>Yes</th>
<th>No</th>
<th>Not Sure</th>
<th>Not Applicable</th>
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<tbody>
<tr>
<td>39</td>
<td>Does the organization have a capitalization and depreciation policy?</td>
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<tr>
<td>40</td>
<td>Are additions to fixed assets recorded in a fixed asset ledger?</td>
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<tr>
<td>41</td>
<td>Does the fixed asset ledger list descriptions of each item, serial number, location, date of acquisition, cost or fair value if donated, useful life, depreciation method, accumulated depreciation and funding source if title remains with the grantor?</td>
<td></td>
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<tr>
<td>42</td>
<td>Is the fixed asset ledger reconciled with the general ledger periodically?</td>
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<tr>
<td>43</td>
<td>Are purchase, transfer and disposal of fixed assets promptly recorded in the ledger?</td>
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<tr>
<td>44</td>
<td>Does the organization conduct a physical inventory annually and update the fixed asset ledger?</td>
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### Financial Statements

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<tr>
<td>45.</td>
<td>Is a statement of financial position prepared monthly and reviewed by the management and the finance committee?</td>
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<tr>
<td>46.</td>
<td>Are monthly reports comparing income and expenses with approved budget by activity prepared and reviewed by the management and the finance committee?</td>
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<tr>
<td>47.</td>
<td>Is an updated cash flow projection prepared and reviewed by the management and the finance committee?</td>
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### General

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<tr>
<td>48.</td>
<td>Is a Chart of Accounts used?</td>
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<tr>
<td>49.</td>
<td>Is fund accounting used to track restricted grants and their spending?</td>
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<tr>
<td>50.</td>
<td>Are accounting records up to date, and monthly financial statements prepared on a timely basis (timely being defined as 10 days to 3 weeks maximum)?</td>
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<tr>
<td>51.</td>
<td>Does the board of directors approve the annual budget?</td>
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<td>52.</td>
<td>Does an accounting procedure and policies manual exist that is reviewed and revised annually?</td>
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<tr>
<td>53.</td>
<td>Do accounting staff take annual vacation and are their basic duties performed by someone else in their absence?</td>
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<tr>
<td>54.</td>
<td>Are all appropriate federal, state, and local information returns filed on a timely basis?</td>
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Part V. Audits and Reporting

The following information on Audits, except as noted, is taken/adapted from “Understanding the Auditor’s Report”, an on-line article prepared by the Credit Research Foundation of Columbia, Maryland.

Dependable financial information and the reporting of financial information, as required, are essential to the very existence of nonprofit organizations. Economic resources are attracted to organizations that show themselves, by accounting measurements, to be capable of using resources to the best advantage and carrying out their responsibilities under the law. These activities fall into two categories: audits and other reporting requirements.

Nonprofit organizations are often required by governmental agencies or other funding sources to have an independent audit conducted by a certified public accountant (CPA). It is a wise nonprofit organization that imposes this requirement upon itself (if others have not). Audited financial statements are the accepted means by which nonprofit (and for profit) organizations report their financial position. The private foundation in making a decision to fund an organization, the banker in making a loan, the government in providing grant dollars, the private citizen in giving in a contribution, will all place more weight on information provided by independent sources, especially those individuals with professional training, competence and integrity.

What is an Audit?

An audit consists of various procedures an independent auditor/professional accountant may use to test transactions and internal controls so as to form an opinion on the accuracy of the presentation of the organization’s financial statements (the Statement of Financial Position, the Statement of Activities and the Statement of Cashflows) for the period covered by the audit. The goal of an audit is to determine whether these statements have been prepared in conformity with generally accepted accounting principles (GAAP) in the U.S.

An audit is not an examination of every financial transaction, but rather a series of tests conducted to allow the accountant to determine how effectively the records were kept and how reliable the organization’s internal controls are. The results of these tests permit the auditor to express an opinion on the financial position of the organization, as a whole. The audit is conducted in accordance with generally accepted auditing standards (GAAS), and, if necessary, other applicable requirements, such as those imposed by the U.S. Office of Management and Budget (see Part VI. Managing Federal Funds).

An audit is not designed for the purpose of uncovering a “wrongdoing”. Because an auditor does not examine all transactions, an audit cannot be relied on to detect fraud or similar irregularities. Therefore, the discovery of irregularities may or may not occur as a direct consequence of an audit. The auditor does, however, assist management in meeting its responsibilities for safeguarding assets by suggesting improvements in the internal accounting
controls and procedures to reduce opportunities for errors and mishandling and the likelihood of their occurring.

The bottom line of an audit is the “Auditor’s Opinion” and the word “opinion” is important here. The auditor does not give guarantees or assurances that financial statements are accurate or reliable (the responsibility for the content of financial statements rests with the organization). Although, as an independent expert, the weight of an auditor’s opinion has additional value, however it is still an opinion and nothing more.

This lack of a guarantee that the organization’s financial house is “in order” should not inhibit an organization from performing an annual audit (whether required by a funder or not). This activity is one of the most important ways that an organization can demonstrate its fiduciary responsibilities to funders, government agencies, and the public at large.

**Selecting an Auditor**

The audit and certification is generally accepted as adequate endorsement of the correctness of a financial statement, but entities that use these statements often take two additional factors into consideration: the experience of the auditor with the type of “business” audited and how often the client’s books are examined. Nearly every trade and industry has a group of auditors who concentrate their practice and become authorities in that field. Often this specialization is along functional lines. Therefore, a nonprofit organization is best served by undergoing an annual audit by an auditor who understands the unique characteristics of nonprofit accounting and auditing.

Importantly, according to generally accepted auditing standards, the auditor chosen to carry out an organization’s audit must be “independent” in all matters of the audit. This means that an accountant who has provided significant non-audit services to an organization throughout the year should not be retained to carry out its audit. These non-audit services are those considered management functions. For example, an accountant who maintains an organization’s official accounting records; prepares, posts, and/or executes transactions (whether coded by management or not coded); makes policy decisions; authorizes or codes transactions; or maintains custody of an organization’s assets (i.e., bank account, etc.) would have an impairment of independence. If your organization has an accountant that provides it with significant non-audit services, they should not also be doing your audit. In these circumstances, the accountant/auditor and you need to make a choice as to which of these services the accountant/auditor will provide.
Preparing for an Audit

The following information comes from the Alliance for Nonprofit Management ("How do we prepare for an audit? on-line FAQ).

Most organizations select an auditor prior to the end of their fiscal year, and at about the time their fiscal year ends, they meet with their auditor to determine what information will be required for the audit. If an organization’s financial management system is reasonably well organized, its audit can usually begin within two months of the end of their fiscal year. Auditors should prepare a list of records that they will need to examine during an audit. If an auditor doesn’t provide an organization with this information, the organization should ask them what it will need to provide.

The following list is representative of information an auditor is likely to require from an organization.

- **Confirmations**: some auditors will ask an organization to provide confirmation of the money it owes or is owed to it. Organizations can prepare confirmation letters indicating amounts shown in their accounting records and request the entities that owe or are due monies to confirm that this is correct. (Commitment letters are written on an organization’s letterhead and mailed back to the auditor.) The alternative to this is for the auditor to prepare the confirmation letters.

- **Evidence of Internal Controls**: Auditors typically assess internal controls through interviews with staff members, review of internal controls procedures manuals, and/or questionnaires that document procedures related to spending and receiving money, entering transactions, etc.

- **Documentation of the following**:
  - Assets: generally (1) Accounts Receivable—who owes you money, how much, and when is it due; and (2) Property and Equipment (fixed assets)—when was it acquired, for how much, how is it depreciated.
  - Liabilities: generally (1) Payables—who do you owe money to and how much do you owe; and (2) deferred revenue.
  - Revenue: includes (1) grants and contributions—funder/donor names and addresses, grant period, amount, when received, restrictions and copies of grant applications and letters; (2) donated services and materials; (3) income (less expenses) raised from fundraising activities; (4) documentation of income from contract services; and (5) an inventory of items sold.
  - Expenses: includes (1) payroll records, including timesheets, tax returns, etc.; (2) documentation of other expenses such as rent, utilities, contract services, etc.
In addition to the above, the auditor may also review board minutes, leases and other contracts, bank statements, bank reconciliations, checkbooks, and canceled checks, financial files for paid bills and deposits, components of the accounting systems (such as the chart of accounts, journals and ledgers, printouts, trial balances, etc.), and the budget for the fiscal year being examined. Importantly, the more complete, accurate and accessible the records and other information that can be provided in advance of or during an audit, the more smoothly, quickly, and inexpensively an audit can occur.

The Audit Trail

A key technique in any audit is to follow the “audit trail”. Maintaining an audit trail means that every payable or receivable has a corresponding source document and that the financial transaction can be traced from this source document to an entry in a subsidiary ledger or journal and then to an entry in the organization’s general ledger or from the general ledger to the source document. (General journal entries, in addition to financial transactions, are also reviewed.)

During this process the auditor also conducts an analytical review of financial records, looking at relationships and/or differences between expenses and budgeted costs. In this way, the audit trail also maintains a connection between financial transactions and the organization’s budget. As the auditor follows the trail, it makes a check on the records maintained by the organization, such as the use of the budget reports, the security of the records (especially personnel records), etc., and assesses the internal controls in place to handle financial transactions.

In conducting an audit, an auditor generally selects different types of transactions from a file and then follows the trail for each of them through the organization. The randomly selected transactions may: (1) represent different types of expenditures, such as wages, supplies, equipment purchase, contracted services, travel reimbursements, etc.; (2) use different forms (i.e., source documents vs. journal entries); and (3) involve different types of receipts, such as fees for service, reimbursements or grant awards.

The audit will compare the dollar amounts in the budget, accounting forms, organization records, budget reports, receipts, invoices, canceled checks, cash transmittal forms, and bank statements. The review will determine whether the proper forms are being used, the information is being recorded correctly, the signatures are original (signature stamps are not recommended for security reasons), proper office records are being maintained for each form, security practices are realistic, cash in the office is protected, the elapsed time to process the different forms is appropriate, and so on.

As documents are traced through the organization, the auditor checks for the proper use of subsidiary ledgers, the general ledger, source documents (such as invoices, receipts, cash
transmittal forms, internal purchase orders, receiving slips, and vouchers), cash deposit forms, monthly reports, bank reconciliation statements, and financial reports. When these documents are examined, the budget numbers, receipt numbers, names of vendors or customers, and other information required by the policies of the organization are checked and documented in the auditor’s work papers. Additionally, the auditor confirms financial transactions with outside parties.

**Understanding the Auditor’s Report**

The contribution of the independent auditor is to give credibility to an organization’s financial statements. Here “credibility” means that the financial statements can be believed; that is, they can be relied upon by entities outside the organization. Accountants, however, have their own language. The following are key to understanding the nature of an audit and the Auditor’s Report:

- The Auditor renders a report on an organization’s financial statements, not on its accounting records. The primary purpose of an audit is to provide assurance to the users of the financial statements that these statements are reliable. Auditors do not express an opinion on the client’s accounting records, however, the auditors’ investigation of financial statement items includes reference to the client’s accounting records (but is not limited to these records). The auditors’ examination includes observation of tangible assets, inspection of such documents as purchase orders and contracts, and the gathering of evidence from outsiders including banks and customers, as well as analysis of the client’s accounting records.

- As described previously, a principal means of establishing the validity of an organization’s Financial Statements is to trace the statement figures to the accounting records and back through the records to the original evidence of transactions (the “audit trail”). However, the auditors’ use of the accounting records is only a means to an end and merely a part of the audit. It is, therefore, appropriate for the auditors to state in their report that they have made an audit of the financial statements rather than to say that they have made an audit of the accounting records.

- Contrary to popular belief, a certified public accountant’s letter of opinion is not a certification or a guarantee. It’s actually nothing more than an opinion. As a professional, the accountant expresses a detached judgment. He or she says, in effect, that proper accounting principles “appear” to have been applied consistently by management and that standard auditing procedures deemed applicable under particular circumstances have revealed nothing which would cause him or her to question the fairness of the resultant statements.

- Expressing an independent and expert opinion on the fairness of financial statements is the most important and valuable service rendered by the public accounting profession. The auditors’ standard report states that the examination was performed in conformity with
generally accepted auditing standards in the U.S. and by expressing an opinion that the client's financial statements are presented fairly in conformity with generally accepted accounting principles in the U.S. However, if there are deficiencies in the client's financial statements or limitations in the auditors' examination, or if there are other unusual conditions about which the readers of the financial statements should be informed, auditors cannot issue the standard report. Instead, they must carefully modify their report to make these problems or conditions known to users of the audited financial statements.

- Some of the items on a financial statement cannot be subjected to exact measurement. By their very nature, certain of these items must represent estimates and approximations. Unfortunately, many of these may “materially” affect either or both the condition of an organization at a given point in time, or the results of operations over a period of time. [In accounting terms, “material” (materiality) refers to information important enough to change a reader's (or investor's) decision. Insignificant information has no effect on decisions, so there is no need to report it. Materiality includes the absolute value and relationship of an amount to other information. So, in an audit, a “material weakness” is a condition in which internal controls do not reduce to a relatively low level the risk that material errors or fraud may occur and not be detected in a timely period by employees in the normal course of their duties.] However, funders and the public are justified in looking to the certified public accountant for a value based on informed judgment.

- It is important to again recognize that the financial statements and all supplemental data that may accompany the statements are the responsibility of the organization. The organization has the responsibility for maintaining adequate accounting records and of preparing proper financial statements. Even though the financial statements are sometimes constructed and produced in the auditors' office, the primary responsibility for the statements remains with the organization. The auditor assumes responsibility only for the opinion that accompanies their report. It is a separate document from the client's financial statements, although the two are closely related and transmitted together. In other words, the auditors' product is their report, not the client's financial statements.

**Reporting Phase of the Audit**

The reporting phase of an audit begins when the independent auditor has completed their fieldwork and their proposed adjustments have been accepted and recorded by the client. Before writing their report, the auditor must review the client-prepared financial statements for form and content, or draft the financial statements on behalf of the client.

The financial statements on which an independent auditor customarily reports are the Statement of Financial Position, the Statement of Activities and the Statement of Cash Flows. Financial statements generally are presented in comparative form for the current year and the preceding year and are accompanied by explanatory notes.
Financial Statement Disclosure

The purpose of notes to financial statements is to achieve adequate disclosure when information in the financial statements is insufficient to attain this objective. Although the notes, like the financial statements themselves, are representations of the client, the independent auditor generally assists in drafting the notes.

Adequate disclosure in the notes to financial statements is necessary for the auditor to issue an “unqualified” opinion (see following description) on the financial statements. Disclosure requirements that have become a part of the basic financial statements include the disclosure of significant accounting policies, accounting changes, loss contingencies, and lease, loan and pension information.

Detecting Misstatements

Generally accepted accounting principles in the U.S. require that the financial statements be free from material misstatements. An auditor has a responsibility to detect various types of material misstatements, including errors, irregularities and those caused by illegal acts. The auditor is required to assess the risk that errors and irregularities affecting the organization's financial records have occurred; and the audit is designed to provide reasonable assurance of detecting errors and irregularities that are material to the financial statements.

The Auditors' Unqualified Report

In accounting, the term “qualified” does not refer to being competent or adequate but instead means limited or modified in some way, as in “I should qualify that statement by saying...”. An “unqualified opinion” is an audit opinion that the financial statements as a whole are in conformity with U.S. GAAP. The standard unqualified report is regarded as a clean bill of health, meaning the auditor made no exceptions and inserts no qualifications in the report. An unqualified opinion can be expressed only when the independent auditor has formed the opinion on the basis of an examination made in accordance with generally accepted accounting principles in the U.S., applied on a consistent basis and includes all informative disclosures necessary to make the statements not misleading.

The standard unqualified report consists of three paragraphs. The first paragraph clarifies the responsibilities of management and the auditor, and is referred to as the introductory paragraph. The second paragraph describes the nature of the audit and is called the scope paragraph. The final paragraph is the opinion paragraph, which is a concise statement of the auditor's opinion based on the audit. The auditor's report is addressed to the persons who retained the auditor.
The Introductory Paragraph: The introductory paragraph emphasizes that the client company is primarily responsible for the financial statements and that the auditor renders a report on the financial statements, not on the accounting records.

The Scope Paragraph: The scope paragraph describes the nature of the audit, that it was conducted in accordance with generally accepted auditing standards and provides reasonable assurance that the financial statements are free of material misstatement.

The Opinion Paragraph: In the opinion paragraph, the auditors are expressing nothing more than an informed opinion. They do not guarantee or certify that the statements are accurate.

Example of an Independent Auditors' Report:

To the Board of Directors of ABC Nonprofit:

We have audited the accompanying Statement of Financial Position of ABC Nonprofit as of December 31, 2001, and the related Statements of Activities and Cash Flows for the year then ended. These financial statements are the responsibility of the Organization's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards in the U.S. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by the organization’s management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of ABC Nonprofit as of December 31, 2001, and the results of its operations and its cash flows for the year then ended in conformity with generally accepted accounting principles in the United States of America.

Nonprofit Accounting Co.
Certified Public Accountants
March 1, 2002
Other Types of Auditors’ Reports

Alternatives to an unqualified report include an unqualified opinion with explanatory language, a qualified opinion, an adverse opinion, or a disclaimer of opinion.

- **Explanatory language added to the Unqualified Opinion:** Certain circumstances require an auditor to add explanatory language to the standard report. Adding the additional language is not regarded as a qualification because it does not lessen the auditor’s reporting responsibility for the financial statements. An Auditor adds explanatory language to an unqualified opinion to indicate: a division of responsibility with another CPA firm; to indicate an inconsistency in the application of accounting principles; to emphasize a matter; to justify a departure from officially recognized accounting principles; and, to refer to an uncertainty that could have a material impact on the financial statements. A situation in which explanatory language is used is illustrated in the following example:

  “Ability to Continue as a Going Concern”

  A special type of significant uncertainty that is important to funders (and the organization) concerns the ability of an organization to continue as a going concern. Under generally accepted accounting principles in the U.S., both assets and liabilities are recorded and classified on the assumption that the company will continue to operate. Assets, for example, may be presented at amounts that are significantly greater than their liquidation values.

  Conditions that may cause an auditor to question the going-concern assumption include negative cash flows from operations, defaults on loan agreements, adverse financial ratios, and legal proceedings. If a substantial doubt exists about the organization’s ability to continue as a going concern for a period of one year from the balance sheet date, the auditors modify their report by adding a final paragraph such as the following:

  “The accompanying financial statements have been prepared assuming that ABC Nonprofit will continue as a going concern. As discussed in Note 1 to the financial statements, ABC Nonprofit has suffered recurring losses from operations and has a net capital deficiency that raises substantial doubt about the entity's ability to continue as a going concern. Management’s plans in regard to these matters are also described in Note 1. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.”

- **Qualified Opinions:** Qualifications with respect to an auditor’s opinion may be broadly classified into two categories: (1) those qualifications which relate to the scope of the examination, and (2) those qualifications with respect to the fairness of presentation in accordance with consistently applied generally accepted accounting principles. A qualified opinion restricts an auditor’s responsibility for fair presentation in some areas of the
financial statements. The opinion states that except for the effects of some deficiency in the financial statements, or some limitation in the scope of the auditor’s examination, the financial statements are presented fairly. All qualified reports include a separate explanatory paragraph before the opinion paragraph disclosing the reasons for the qualification.

- **Adverse Opinions:** An adverse opinion is the opposite of an unqualified opinion; it is an opinion that the financial statements do not present fairly the financial position, results of operations, and cash flows of the organization, in conformity with generally accepted accounting principles in the U.S. The auditor should express an adverse opinion if the statements are so lacking in fairness that a qualified opinion would not be warning enough. Whenever an auditor issues an adverse opinion, they should disclose in a separate paragraph of the report the reasons for the adverse opinion and the principal effects on the financial statements of the matters causing the adverse opinion.

- **Disclaimer of Opinion:** A disclaimer of opinion is no opinion. In an audit engagement, a disclaimer is required when substantial scope restricts or other conditions preclude the auditor’s compliance with generally accepted auditing standards in the U.S. A disclaimer of opinion generally refers to a situation where the organization may be “unauditable” because of a lack of availability of records or lack of cooperation of management.

**Changing Auditors**

When an organization changes auditors, investors (funders) may want to know why. A desire to lower auditing costs is a common reason, however, an organization should carefully evaluate whether a less expensive auditor is, in fact, the best alternative. For instance, a substantial cut in auditing fees may mean lower quality auditing work and less verification effort. A change in auditor may also be the result of dissatisfaction with the “results” of an audit. However, here too an organization is most likely best served by an auditor who will inform it of problems and provide suggestions to correct and resolve financial management issues (done through a “Management Letter”). In fact, it is wise for an organization to request a Management Letter from an auditor for this very reason. (Management Letters are not considered part of an organization’s audit but are for use by management only.)

When asked, auditors that no longer work for a particular organization, generally (and often understandably) do not give the reason. However, a funder or contributor or prospective board member, may compare the qualifications of the new auditor with that of the former one. Additionally, according to generally accepted auditing standards, a “successor” auditor is required to communicate with a “predecessor” auditor regarding their knowledge as to reasons for change of auditor and any disagreements with management.
Other Reporting Requirements

By definition, nonprofit organizations are not required to pay income taxes. They are, however, subject to numerous federal and state reporting requirements. These requirements can be categorized into two areas: (1) organizational requirements and (2) requirements of nonprofit organizations who have employees. Even if an organization hires outside help to assist them in meeting these obligations, it is important for board members and staff to be aware of the requirements in order to ascertain that it has been done in a timely manner. Adherence to requirements is critical for an organization to maintain its nonprofit status.

Employees

Every employer (including tax exempt organizations) that pays wages to employees is responsible for withholding, paying, depositing, and reporting federal income taxes, Social Security and Medicare (FICA) taxes, and federal unemployment tax (FUTA), unless that employer is specifically exempt by law from these requirements or if the taxes clearly do not apply (these exceptions generally only apply to the clergy). It is important to keep in mind that Federal and State taxing entities operate by the calendar year. This means that, regardless of the timeframe of a nonprofit's fiscal year, it must pay and report within the January 1 to December 31 time period.

- **Income Taxes:** Every employer must withhold both federal and state income taxes from an employee's wages. (The amount of an employee's tax liability is based on his or her income and the number of exemptions they have claimed on their W-4 form. These exemptions are based on marital status, number of dependents, and other factors.) Although withheld amounts represent amounts owed by employees, an organization is personally liable for those taxes if it fails to properly withhold or deposit them.

- **The Federal Insurance Contributions Act (FICA)** requires all employers to withhold two separate taxes from the wages they pay employees: a social security tax and a Medicare tax. The law also requires employer's to pay an amount equivalent to the amount withheld from the employee's wages. Each of the FICA taxes is withheld at a single flat rate (the taxes are unaffected by the number of withholding exemptions an employee may have claimed for income tax withholding purposes). Currently, the social security tax rate for employees is 6.2% and the Medicare tax rate is 1.45% of an employee's gross wages. An employer must match and pay this amount. The social security tax is subject to a dollar limit, which is adjusted annually for inflation. For 2002, the maximum earnings subject to social security tax is $84,900. There is no limitation for Medicare tax.

Failure to Pay: An organization can be held 100% liable for all income and FICA taxes it “willfully” failed to withhold from an employees' wages or failed to pay to the IRS and
State tax agency. If the conduct was deemed not “willful” (i.e., an employee was misclassified as an independent contractor), smaller penalties are imposed.

- **The Federal Unemployment Tax Act (FUTA)** imposes a payroll tax on employers, based on the wages they pay their employees. This tax is not withheld from an employee’s wages, but is paid by the employer. The FUTA tax is imposed at a single flat rate on the first $7,000 of wages that are paid an employee. Once an employee’s wages for the calendar year exceed $7,000, there is no further FUTA liability for that employee for the year. The FUTA tax rate is a flat 6.2%. However, you can generally claim credits against your gross FUTA tax to reflect the State unemployment taxes you pay. Employers can receive credits (a reduction) on their FUTA obligations if they pay all state unemployment taxes on time, and before the due date of their FUTA tax return. In Nebraska, this credit lowers the FUTA liability to 0.8%.

**Depositing Payroll Taxes**

Federal payroll taxes are generally (see exceptions noted in the following) deposited in a bank or other financial institution that is authorized to accept federal tax deposits or with the Federal Reserve Bank or branch serving an area. In these cases, Form 8109, Federal Tax Deposit Coupon, is used to make the deposit. As for timing, different rules apply to income and FICA taxes and to FUTA taxes. (Organization’s with over $100,000 in withholding in the prior year are required to pay via electronic deposit, however, the IRS can require this method of deposit in other cases also.)

- **Federal Income and FICA taxes:** these are usually deposited on a monthly or semiweekly basis (the IRS will tell you which method to use during the upcoming calendar year). However, if your quarterly taxes are less than $2,500, you can remit the taxes with your quarterly (Form 941- see the following) return in lieu of depositing them.

- **FUTA Taxes:** usually deposited on a quarterly basis, however, if an organization’s quarterly FUTA tax liability is $100 or less, it doesn’t have to be deposited. Rather, it can be carried forward and added to the FUTA liability for the next quarter. If an organization’s liability for the last quarter of the year (plus any undeposited amounts from prior quarters) is $100 or less, it has the option of either depositing the tax or remitting it with their annual return. If an organization’s quarterly FUTA tax liability is more than $100, it must make quarterly FUTA deposits by the last day of the month that follows the end of each quarter. State unemployment taxes (SUTA) are submitted quarterly with Form UI 11T (see the following).
Reporting Income and Payroll Taxes

- **IRS Form 941 (Quarterly by Calendar Year)**
  All employers must file Form 941, Employer’s Quarterly Federal Tax Return, to report both the federal income taxes it withheld and the FICA taxes withheld and paid during a calendar quarter. The deadline for filing the return is the last day of the first month after a quarter ends. In lieu of quarterly reporting, the IRS can require that an organization file on a monthly basis if it has failed to make deposits or file returns when they’re due. Monthly returns, when required, are filed on Form 941-M, Employer’s Monthly Federal Tax Return. The returns are due by the 15th day of each month. Nebraska requires quarterly reporting of state income taxes (Form 941N) by the last day of the month following the end of the quarter, or monthly (if more than $500 is withheld for either of the first two months of a quarter) reporting by the 15th of the following month (Form 501N).

- **IRS Form 940 (Annual by Calendar Year)**
  All employers must file an annual return on Form 940, Employer’s Annual Federal Unemployment Tax Return, to report FUTA taxes paid during the year. Form 940-EZ is also available if: (1) you paid all your unemployment taxes to a single state, (2) you paid all the taxes by their due dates, and (3) all wages that were taxable for FUTA tax purposes were also taxable under the state’s unemployment tax law. The deadline for filing the return for each year is January 31 of the following year.

- **Nebraska Forms UI 11T and UI 11W (Quarterly by Calendar Year)**
  Each quarter, all Nebraska employers must file the Nebraska Unemployment Insurance Combined Tax Report (UI 11T) with the Nebraska Unemployment Insurance Wage Report (UI 11W). Form UI 11W reports gross wages paid to each employee, while Form UI 11T combines the taxable wages of all employees and reports the employer’s tax liability. These forms, with payment, are due to the Nebraska Department of Labor, on or before the last day of the month following the close of the calendar quarter. Additionally, these forms must be filed even if there were no employees or no wages during the calendar quarter.

Other Reporting and Information Returns Required of Employers

**Distributing W-2 Forms to Employees:** W-2 Forms must be provided to each employee who works for an organization during the calendar year. The W-2s must be distributed by January 31 of the year following the calendar year covered by the form. However, employees who were terminated during the course of the year may request that you provide their W-2s at an earlier date. When a terminated employee requests the W-2s earlier, you must furnish the forms within 30 days of the request or, if later, within 30 days of your last payment of wages to the employees. If for any reason you’re unable to distribute a W-2 to an employee,
you should retain the undeliverable form as part of your records. Failure to prepare a Form W-2 for employees, or willfully furnishing incorrect ones, will subject an organization to a $50 penalty for each statement that should have been sent or that was incorrectly prepared.

**Filing W-2s:** An organization must file copies of their employees’ W-2s with the Social Security Administration (SSA) by the end of February. In transmitting the forms, Form W-3 is filed (Transmittal of Wage and Tax Statements). Form W-3N is due to the State of Nebraska by March 15th of each year.

**Correcting W-2s:** If you have the need to correct or replace a W-2 that you’ve distributed to an employee or filed with the SSA, use Form W-2c, Statement of Corrected Income and Tax Amounts.

**Federal Organizational Reporting Requirements**

**IRS Form 990 (Annual by fiscal year)**

All nonprofits (except those with under $25,000 in annual gross receipts, churches, and certain other religious organizations) must file a Form 990 or Form 990-EZ with the IRS each year in order to retain their tax-exempt status. It is required by law, with harsh penalties for those who fail to do so. In many respects it serves as an annual report from the nonprofit to the federal government.

Form 990 (and Form 990-EZ) provides information not found in audited financial statements of nonprofit organizations. This form provides information on the ongoing activities of the organization in support of its tax-exempt status and includes statements regarding all income and expenditures for the year. It covers both qualitative and quantitative data and, when prepared accurately, completely, and truthfully, provides valuable information. The returns are due on the fifteenth day of the fifth month following the fiscal year end.

Importantly, Form 990 is a public report and a means of ensuring and demonstrating accountability. Nonprofit organizations not only must file this report with the IRS, but they also are required to make it available to anyone who demands to see it.

**Other Information Returns**

- Independent contractors. Organizations are required to file a federal information return (Form 1099-MISC) for any independent contractor who has been paid at least $600 as compensation for services. Copies of the return must be provided to the contractors by January 31, and to the IRS by February 28 (filed with Form 1096). An example of when this would be necessary is if an organization hired a planning consultant to prepare a market study, or an accountant to set up the books and advise the organization. One
exception to the $600 limit is for attorney's fees. Gross proceeds of any amount paid to an attorney must be reported with a 1099-MISC form (and Form 1096).

- Form 8282, Donee Information Report, must be filed with the IRS if a donee organization sells, exchanges, or otherwise disposes of gifts of property other than money or publicly traded securities within two years of the gift. This form is not required if the gift was valued at less than $500.

- Form 8300, Report of Cash Payments over $10,000 Received in a Trade or Business, must be filed by any exempt organization that receives, in the course of its activities, more than $10,000 in a single transaction (or 2 or more related transactions) that is not a charitable contribution.

- A charitable organization must provide a written disclosure statement to donors of a quid pro quo (part donation, part payment of goods or services) contribution of $75 or more. This disclosure must indicate the fair market value of the goods or service that must be deducted from the donation. Additionally, a donor cannot deduct a contribution of $250 or more without written acknowledgment from the charitable organization.

**Record Retention**

- Although there is no particular form prescribed for properly retaining records, they must be kept in a manner that will enable the IRS and the state tax authorities to ascertain whether any tax liability has been incurred and, if so, the extent of that liability. So, the types of information that should be retained include:

  - The name, address, and social security number of each employee
  - The total amount and date of each payment of compensation
  - The period of service covered by each payment of compensation
  - The portion of each payment of compensation that constituted taxable wages
  - Copies of each employee's withholding exemption certificate (W-4)
  - Dates and amounts of tax deposits you made
  - Copies of returns you filed
  - Copies of any undeliverable Form W-2
Part VI. Managing Federal Funds

Please Note: This Part contains a discussion of the general rules and requirements guiding Federal programs as presented by Circulars from the U.S. Office of Management and Budget and by HUD Regulations, as contained in the Code of Federal Regulations. This discussion is current upon this date (September 2002), however, organizations are cautioned that Federal rules, regulations, and requirements change from time to time. Importantly, in August 2002, the Office of Management and Budget proposed changes to two of the three Circulars discussed in this Part. While proposed revisions to OMB Circular A-122 are clarifying changes only, the proposed revision to OMB Circular A-133 is significant, changing the threshold for required audits from $300,000 to $500,000. The point here is that this Part of the Primer is intended to give organizations an overview of Federal rules and requirements and should not be considered a definitive guide on this matter. Organizations utilizing Federal funding should make sure that they are administering these funds according to the most recent and complete rules and regulations issued by the governing Federal agency.

Nonprofit organizations that administer programs or undertake projects with Federal funding, may be acting in one of three roles in the funding framework:

- As a grantee or recipient, where Federal funds pass directly from a Federal agency to the nonprofit organization. Examples of this would be Supportive Housing Program grants from HUD to homeless service providers, or Community Services Grants from the U.S. Department of HHS as administered by Community Action Agencies.

- As a subrecipient of a grantee, where Federal funds are allocated or “passed through” to a non-profit organization by a recipient entity. Examples of this would be CDBG or HOME funding allocated by the Nebraska Department of Economic Development (the grantee) to non-profit organizations in the state. It should be noted that CHDOs would fall into this general category although they are not considered “subrecipients” under HOME regulations. This will be discussed at the end of this chapter.

- As an administrator of a program for a subrecipient of a grantee, where Federal funds are awarded to a subrecipient who in turn contracts with a nonprofit organization to administer the program for which funding was awarded. An example of this would be a nonprofit organization that administers a housing rehabilitation program for a community or county that receives CDBG funding for this purpose from the State of Nebraska.

The ultimate responsibility for the financial management of Federal funds rests with a grantee, namely, a public or private entity that receives funding directly from the Federal government. This means that grantees must hold subrecipients to the same standards, restrictions, and requirements that they must meet in utilizing Federal funds. This is the only way that grantees can begin to ensure the Federal funding agency and themselves that they are in compliance with Federal rules and regulations.
The financial management of federal funding, whether it be by a grantee or a subrecipient, is governed by principles and regulations that are set out in the following:

- Congressional law and requirements, as contained in statute.
- Federal Agency Regulations, which interpret the statutes and are contained in the Code of Federal Regulations, or CFR. The regulations governing HUD programs are contained in Title 24 of the Code of Federal Regulations and different programs and regulations are in different parts of the Title 24. For instance, the CDBG program is contained in Part 570 of Title 24, written as 24CFR570. Similarly, the citation for the HOME program is 24CFR92.
- Office of Management and Budget (OMB), which establishes general rules and regulations for Federal programs as contained in “Circulars”. These regulations may also be set out in the CFR. For instance, the rules and regulations prescribed by OMB Circular A-110, which will be described later, is codified by HUD in 24CFR84.
- Generally Accepted Accounting Principles (GAAP), which are developed by the Financial Accounting Standards Board (FASB).

Of particular importance, with respect to the financial and overall management of federal funds by nonprofit organizations are three OMB Circulars. These circulars affect all four of the processes described in this Primer, that is, budgeting, accounting, internal controls, and auditing. The three OMB Circulars of importance are:

- OMB Circular A-110 “Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations”: sets forth standards for obtaining consistency and uniformity in the administration of federal grants by non-profit organizations.
- OMB Circular A-122 “Cost Principles for Nonprofit Organizations”: constitutes the legal basis by which Federal agencies define allowable and unallowable costs and how these costs are calculated.
- OMB Circular A-133 “Audits of States, Local Governments and Non-Profit Organizations” prescribes the audit requirements for non-profit organizations that expend $300,000 or more in Federal award monies within a single fiscal year.

Every non-profit organization that receives federal funding should be knowledgeable of the purpose of these circulars and how they affect the overall and the day-to-day operation of their organization. The following provides a more detailed description of these circulars.
OMB Circular A-110

Circular A-110 ("Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals, and other Non-Profit Organizations") provides federal agencies with uniform and consistent administrative standards for grants and agreements with non-profit organizations. (As indicated previously, HUD’s implementation of A-110 is contained in 24CFR84.) The provisions of A-110 are applied either directly to non-profit organizations (if they are a direct recipient of funding) or indirectly, as a requirement for pass-through funding from a direct recipient (in this case the organization is a subrecipient of federal funding).

A-110 prescribes pre-award, post-award, and after the award (closeout) requirements for organizations that receive federal funding. In many instances, these requirements apply to (direct) recipients only. However, there are numerous requirements that affect subrecipients. The following discussion is not intended to cover all of the rules and regulations contained in OMB Circular A-110 (a full copy of this is contained in Appendix B and HUD’s codification of these rules in 24CFR84 is contained in Appendix C). Instead, this discussion highlights some important points in order to give the reader an overview of the purpose of this circular and the types of regulations contained within it. Particularly important are the “Post-award requirements” which prescribe standards for financial and program management, property standards, procurement standards, reports and records, and termination and enforcement. Significant among these are:

Financial and Program Management Standards: In general, A-110 requires nonprofit organizations using Federal funds to be able to demonstrate the following:

- Accurate, current and complete disclosure of the financial results of each federally-sponsored project or program.
- Records that identify adequately the source and application of funds for federally-sponsored activities.
- Effective control over and accountability for all funds, property and other assets—adequately safeguarding all such assets and assuring they are used solely for authorized purposes.
- Comparison of outlays with budget amounts for each award.
- Written procedures for determining the reasonableness, allocability and allowability of costs in accordance with the provisions of the applicable Federal cost principles and the terms and conditions of the award.
- Accounting records including cost accounting records that are supported by source documentation.
**Procurement Standards:** The procurement guidelines presented in OMB Circular A-110 require written standards of conduct and procurement practices that ensure a nonprofit is paying the most reasonable price for goods and services acquired with federal funds. (Nonprofit organizations may use federal funds to procure items allowed by OMB Circular A-122). Some of the most important features of good procurement standards and practices, as identified in OMB Circular A-110, are:

1. Written standards of conduct for employees, officers, or agents of an organization to eliminate real or perceived conflicts of interest in the award or administration of contracts supported by Federal Funds. As identified by A-110: “Such a conflict would arise when the employee, officer, or agency, any member of his or her immediate family, his or her partner, or an organization which employs or is about to employ any of the parties indicated herein, has a financial or other interest in the firm selected for an award. The officers, employees, and agents of the organization shall neither solicit nor accept gratuities, favors, or anything of monetary value from contractors, or parties to subagreements.”

2. All procurement transactions are conducted in a manner to provide, to the maximum extent practical, open and free competition. In this, A-110 indicates that “in order to ensure objective contractor performance and eliminate unfair competitive advantage, contractors that develop or draft specifications, requirements, statements of work, invitation for bids and/or requests for proposals shall be excluded from competing for such procurements. Awards shall be made to the bidder or offeror whose bid or offer is responsive to the solicitation and is most advantageous to the recipient, price, quality and other factors considered.”

3. Written procurement policies and procedures that ensure:
   - Goods and services are acquired only when needed and at the most reasonable costs; and,
   - Solicitations for goods and services provide for the following: (a) a clear and accurate description of the technical requirements for the material, product or service to be procured (including minimum acceptable standards and, if any, “brand name or equal” descriptions that bidders must meet); (b) requirements which the bidder/offeror must fulfill and all other factors to be used in evaluating bids or proposals; and, (c) preference, to the extent practicable, for products and services that conserve natural resources, protect the environment, and are energy efficient.

4. Positive efforts are made to utilize small business, minority-owned firms and women’s business enterprises, wherever possible.

5. Prohibition of contracts with “Debarred or Suspended” contractors.
(6) Procedures for obtaining the best possible prices for items or services procured, and documentation of efforts to do so. Competitive bids are not required for smaller procurements, however, the rationale for selection (i.e., using a vendor that historically has provided low prices; not awarding a contract to the low bidder but to one who is expected to give superior quality and service, etc.) should be included within the nonprofit’s written procurement procedures. This is especially true for procurements over $25,000 (the small purchase threshold). For all procurements over this threshold, an organization must maintain files and records with the following:

- Basis for contractor selection;
- Justification for lack of competition when competitive bids or offers are not obtained; and,
- Basis for award cost or price.

Expenditures over $100,000 require a higher standard, usually involving competitive bids. In addition to this, procurement of construction services over this level must adhere to bonding requirements.

(7) A system for contract administration that assures contractor conformance with the terms, conditions and specifications of the contract and adequate and timely follow-up of all purchases is established. All contracts over the small purchase threshold must contain the following provisions as applicable:

1. Equal Employment Opportunity;
2. Copeland “Anti-Kickback” Act;
3. Davis-Bacon Act, as amended;
4. Contract Work Hours and Safety Standards Act;
5. Rights to Inventions Made Under a Contract or Agreement;
6. Clear Air Act and the Federal Water Pollution Control Act, as amended;
7. Byrd Anti-Lobbying Amendment; and,
8. Debarment and Suspension.

Contracts in excess of the small purchase threshold must contain contractual provisions or conditions that allow for remedial measures in instances where the contractor violates or breaches the contract terms, and for termination.

**Records Retention.** According to A-110, financial records, supporting documents, statistical records, and all other records pertinent to an award must be retained for a period of 3 years from the date of submission of the final expenditure report, and longer if required by the organization’s awarding agency. For instance, HUD requires a 4-year retention period for
CDBG records and 5 years for HOME records (this period is extended to include the affordability period). Exceptions to this are in cases of:

- Records for projects or programs for which there is any litigation, claims, or audit findings started before the expiration of the retention period must be retained until all litigation, claims or audit findings are resolved.
- Records of real property and equipment acquired with Federal funds must be maintained for 3 years or longer after final disposition of such property or equipment.

Non-profits are sometimes too good at record retention. If HUD audits uncover problems in records held beyond the required time, the problems will be cited in the audit. Nonprofit organizations that are uncertain about meeting record retention rules should contact their local HUD office for instructions.

**Property and Equipment.** The property and equipment standards contained in OMB Circular A-110 define how nonprofits should treat real property and equipment purchased with federal funds. These standards require periodic inventories and other procedures to safeguard assets. The most important feature in this section is that nonprofits have a listing of all equipment owned and that a periodic count or other procedure is performed to check the listing.

Other important property and equipment standards are:

- Federally-funded property and equipment should be insured at the level the organization insures other property and equipment.
- A maintenance schedule should be developed and followed.
- Approval of the funding agency is needed to dispose of real property (unless disposal was intended within the program, as with acquisition/rehab/homeownership programs), encumber real property with debt, use it in any other way than the original purpose or to trade-in or sell equipment.

**Other Post Award Requirements of A-110:** In addition to financial and program management standards, procurement standards and records retention, OMB Circular A-110 also prescribes guidelines for the acceptability and value of contributions used in cost sharing or matching. In this area, A-110 indicates that all contributions, including cash and third party in-kind, shall be accepted as part of the recipient’s cost sharing or matching when such contributions are: (1) verifiable; (2) not included as contributions for another program/project; (3) necessary and reasonable to accomplish program objectives; (4) allowable under the applicable cost principles; and, (5) provided in the approved budget. A-110 also indicates how program income must be treated and the procedure for reporting deviations from program budgets and plans and requesting prior approval for revisions to these.
**OMB Circular A-122**

OMB Circular A-122 establishes the principles by which federal agencies determine the costs of work performed by nonprofit organizations under awards (grants, contracts and other agreements). The principles are designed so that the federal government bears its fair share of costs except where restricted or prohibited by law. In general, Circular A-122 prescribes what costs are and are not allowable, and what costs are allowable under certain conditions or with prior approval from the funding entity. In addition to prescribing the allowability of costs, A-122 also prescribes the allocability of costs, that is, how they may be charged to a particular award. A full copy of Circular A-122 is contained in Appendix D.

**Basic Considerations:**

To be allowable, costs must meet the following general criteria:

- Costs must be **reasonable**. In determining reasonableness of a given cost, consideration if given to:
  - Whether the cost is of a type generally recognized as ordinary and necessary in the performance of the award.
  - The restraints or requirements imposed by such factors as: sound business practices; arms length bargaining (a less-than-arms-length transaction is one under which one party to the transaction is able to control or substantially influence the actions of the other); laws and regulations, and terms and conditions of the award.
  - Whether the individuals concerned acted with prudence.
  - Significant deviations from the established practices of the organization which may unjustifiably increase the cost.

- They must be **allocable**. A cost is allocable to a particular cost objective if the goods or services involved are chargeable or assignable to such cost objective in accordance with relative benefits received. This means that costs can be direct or indirect.
  - **Direct Costs** are costs that can be identified specifically with a particular final cost objective (i.e., a particular award, project, service, etc.). In other words, these are costs that would not be incurred if the award/project/program did not exist. All costs that are identifiable with a particular program should be treated as direct costs. Typical direct costs include staff needed to carry out the program/project, materials acquired, consumed or expended for the purpose of the award, equipment and other approved capital expenditures, and travel. For example, a nonprofit organization operates a first time homebuyer program. The costs associated with taking applications, inspecting properties, performing underwriting activities, completing the necessary paperwork to provide assistance, and providing homebuyer counseling would be considered direct costs. If the executive director of this organization provides both direct program
services as well as overall administration of the organization, this person’s salary and related expenses are, in proportion, directly allocated to both cost areas. The portion of the director’s time not specifically associated with the homebuyer program could be considered an indirect cost to that activity (see the following).

- **Indirect Costs** are costs that benefit both the award and other work of the organization and cannot readily be identified with a particular final cost objective. In other words, indirect costs benefit all activities of an organization. Indirect costs are classified within two broad categories:
  - “Facilities” Costs include operations and maintenance expenses (i.e., occupancy costs, utilities, furniture and equipment, property and liability insurance, clerical salaries, etc.), and depreciation or use allowances on buildings, equipment and capital improvements, etc.; and,
  - “Administrative” Costs are defined as expenses incurred for the overall executive and administrative offices of the organization and other expenses of a general nature, which do not relate solely to any major function of the organization. In other words, costs necessary for the organization to stay in existence. Examples of Administrative costs include general oversight, business management, budgeting, financing, fundraising, and public relations activities.

It should be noted that Administrative Costs in the above context and those applicable to a particular grant have two different meanings. Administrative costs of a particular program would actually be a direct program cost and are generally budgeted as such.

**Methods of Indirect Cost Allocation.** Organizations that want to charge indirect costs to a Federal award or awards must prepare an indirect cost rate proposal for submission to, and review and approval by, its “cognizant” Federal agency. For organizations that receive most of their funding from HUD, that federal agency would be HUD. Organizations without an established indirect cost rate with a Federal agency must submit its initial indirect cost proposal no later than three months after the effective date of an award. Organizations with previously established indirect cost rates must submit a new indirect cost proposal to its cognizant agency within six months after the close of each fiscal year.

In general, indirect cost rates establish the ratio (a percentage) of indirect costs to a direct cost base. Organizations can allocate indirect costs using a (1) simplified allocation method; (2) multiple allocation base method, or (3) direct allocation method. The simplified method and the direct method are the easiest and most commonly used by smaller nonprofit organizations and are described below.
The Simplified allocation method should be used when an organization has only one major function and this function benefits from its indirect costs to approximately the same degree. This method should also be used where an organization has only one major function encompassing a number of individual projects or activities, and may be used where the level of Federal awards to an organization is relatively small. In this method, indirect costs are allocated as follows:

1. Separate total costs for a base period (usually a fiscal year) as either direct or indirect. (Capital expenditures and other distorting items of costs, such as major contracts are excluded.); and,

2. Establish an equitable distribution base such as salaries and wages, or FTEs.

3. Divide the total allowable indirect costs by the base to derive the rate (percentage) at which indirect costs can be distributed to individual awards.

In a simplified example, let’s say that an organization has a total of 3.0 FTE employees, and one employee works full time in carrying out a specific project. Under the simplified allocation method, the indirect cost rate for this program is 33.3% and the organization could charge one-third of its allowable Facilities and Administration costs to this project.

Importantly, although the costs of certain activities are not allowable as charges to Federal awards (for example fundraising costs), these costs must nonetheless be treated as direct costs for purposes of determining indirect cost rates. In this respect, these activities must be allocated their share of the organization’s indirect costs if they represent activities which (1) include the salaries of personnel, (2) occupy space, and (3) benefit from the organization’s indirect costs.

In the Direct Allocation Method, all costs are treated as direct, except for administration and general expenses. Under this method, costs are separated into three categories: (1) general administration and general expenses; (2) fundraising; and, (3) other direct functions (including projects performed under Federal awards). Typical shared/common costs, such as rent, depreciation, telephone, maintenance, etc., are individually prorated to functions (administration, fundraising, and other direct functions) as direct costs using a base most appropriate to each particular cost.

Importantly, any cost allocable, directly or indirectly, to a particular award may not be charged to other Federal awards.
Costs, direct or indirect, must be **allowable**. Generally, allowable costs are those that are: necessary and reasonable for proper and efficient performance and administration of Federal awards; allocable under the provisions of Circular A-122; authorized or not prohibited under State or local laws or regulations; adequately documented; and, in conformance with the terms and conditions of the Federal award, or other governing regulations as to types or amounts of cost items.

Attachment B of Circular A-122 provides the principles to be applied in establishing the allowability or unallowability of certain items of cost. These principles apply whether a cost is treated as direct or indirect.

### Selected Items of Cost identified in A-122

The following is a summary of some of the costs addressed by OMB Circular A-122. For a complete listing and detailed descriptions of costs, as well as the rules for determining direct and indirect costs and the allocability of indirect costs as described in the previous section, please refer to Circular A-122 in its entirety (see Appendix D). It should be noted that A-122 points out that “Failure to mention a particular item of cost is not intended to imply that it is unallowable; rather, determination as to allowability in each case should be based on the treatment or principles provided for similar or related items of cost.”

**Advertising and Public Relations Costs: Allowable only if:**

- Advertising costs are: (1) for the recruitment of personnel, (2) for the procurement of goods and services, (3) for the disposal of surplus materials (only if disposal costs are not reimbursed based on a standard rate as specified in the Common Rule), or (4) for any other specific purposes needed to meet the requirements of the Federal award.

- Public relations costs are: (1) specifically required by sponsored awards, (2) incurred to communicate specific activities or accomplishments resulting from performance of the Federal awards (again only as a direct cost), or (3) necessary communication liaison to keep the public informed on matters of public concern.

Advertising and public relations costs related to fundraising and organizational activities are specifically not allowed.

**Alcoholic beverages: Not Allowable**

**Bad Debts: Not Allowable**

Bad debts and the legal or other costs associated with collection attempts are unallowable.
**Bonding Costs: Allowable**

Costs of bonding employees and officials are allowable to the extent that such bonding is in accordance with sound business practice and rates are reasonable.

**Communication Costs: Allowable**

Costs for telephone services, local and long distance calls, postage and the like are allowable.

**Compensation for Personal Services: Allowable**

Compensation includes all remuneration for services of employees rendered during the period the Federal award. It includes, but is not limited to, salaries, wages, director’s and executive committee member’s fees, incentive awards, fringe benefits, pension plan costs, and cost of living differentials. The costs of such compensation are allowable to the extent that they are reasonable for the services rendered (consistent with that paid for similar work in the organization’s other activities and in the labor market in which the organization competes for employees) and conforms to the established policy of the organization consistently applied to both Federal and non-Federal activities.

- Compensation for personal services may be direct or indirect. Fringe benefits in the form of vacation, sick pay, holidays, and authorized absences are allowable provided such costs are absorbed by all organization activities in proportion to the relative amount of time or effort actually devoted to each.

- Fringe benefits in the form of social security, employee insurance, workers compensation, pension plans, etc., are allowable provided they are distributed in accordance with salaries and wages chargeable to particular awards and activities.

- Charges to Federal awards for salaries and wages (whether direct or indirect) must be supported by documented, approved payroll records:
  - Distribution of salaries and wages must be supported by personnel activity reports (time sheets).
  - Time sheets must be maintained by all personnel whose compensation in whole, or in part, is charged to government awards.
  - Time sheets must reflect after-the-fact determination of actual activity of each employee.
  - Each time sheet must account for employees’ total time.
  - Time sheets must indicate total number of hours worked each day.
  - Time sheets must be signed by employee and approved by a responsible supervisory official of the organization.
• Time sheets must be prepared at least monthly and coincide with one or more pay periods.

• To support the allocation of indirect costs, payroll reports must also be maintained for other employees whose work involves two or more functions or activities if a distribution of their compensation is needed to determine the organization’s indirect cost rate.

• Salaries and wages of employees used in meeting cost sharing or matching requirements on awards must be supported in the same manner.

**Contingency Provisions: Not Allowable**
Contributions to a contingency reserve or any similar provision made for unforeseen events are unallowable. The term contingency reserve excludes self-insurance reserves, pension funds, and other reserves for normal severance pay.

**Contributions: Not Allowable**
Contributions and donations by an organization to others are unallowable.

**Depreciation and Use Allowances: Allowable Except For:**

- The cost of land,

- Any portion of the cost of buildings and equipment borne or donated by the federal government irrespective of where title was originally vested or where it presently resides,

- Any portion of the cost of buildings and equipment contributed by or for the organization in satisfaction of a matching requirement.

Under the depreciation methodology for calculating cost, capital assets are depreciated based on their acquisition costs divided by their estimated useful life and consumption pattern. Under the use allowance methodology for calculating costs, an annual rate not exceeding 2% of the acquisition costs of buildings and improvements and 6% of the acquisition cost of equipment is used.

Charges for use allowances or depreciation must be supported by adequate property records, including depreciation records indicating the amount of depreciation taken each period.

**Donations: Not Allowable**
Donated or volunteer services and/or goods and space may be furnished to an organization, but the value of these is not reimbursable either as a direct or indirect cost. The fair value of donations, however, may be used to meet cost sharing or matching share requirements. If donations are treated as indirect costs, indirect cost rates will separate the value of the donations so that reimbursement will not be made.
Entertainment Costs: Not Allowable
Costs of entertainment, including amusement, diversion, and social activities, and any costs related to such (e.g., meals, lodging, rentals, transportation and gratuities) are unallowable.

Equipment and Other Capital Expenditures: Allowable with approval
Equipment is defined as nonexpendable tangible personal property having a useful life of more than one year and an acquisition cost which is the lesser of (a) the organization's capitalization level or (b) $5,000. Capital expenditures for general purpose equipment, such as equipment that is usable for purposes other than research, medical, scientific or technical activities, are unallowable as a direct cost except with prior approval of the awarding agency. Examples of general purpose equipment include office equipment and furnishings, reproduction and printing equipment, motor vehicles, and data processing equipment.

Capital expenditures for land or buildings, or improvements to land, buildings, or equipment which materially increases their value or useful life, are unallowable as a direct cost except with the prior approval of the awarding agency. Equipment and other capital expenditures are unallowable as indirect costs. (See Depreciation and Use Allowances for allowability).

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

Goods and Services for Personal Use: Unallowable
Costs of goods or services for personal use of the organization's employees are unallowable regardless of whether the cost is reported as taxable income to the employees.

Housing and Personal Living Expenses: Allowable, with exceptions
Costs of housing, housing allowances and personal living expenses of the organization's officers (including past officers and employees) are unallowable as fringe benefit or indirect costs regardless of whether the cost is reported as taxable income to the employees. These costs are allowable as direct costs to sponsored award when necessary for the performance of the award and approved by awarding agencies.

Idle Facilities and Idle Capacity: Unallowable, with exceptions
The costs of maintaining, repairing, housing, or renting (including related costs such as property taxes, insurance, etc.) completely unused or partially unused facilities in excess of the organization's current needs are unallowable except to the extent that they are necessary to meet fluctuations in workload or were originally reasonable, in which case costs are
allowable for a period not to exceed one year and actions are taken to use, lease, or dispose of such facilities.

**Insurance and Indemnification: Generally Allowable**

The costs of insurance required or approved, and maintained, pursuant to an award, or maintained by the organization in connection with the general conduct of its operations are allowable. The types and extent of this coverage, however, must be in accordance with sound business practices and the rates and premiums must be reasonable.

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

**Interest, Fundraising, and Investment Management Costs: Unallowable**

Costs of organized fundraising, including financial campaigns, endowment drives, solicitation of gifts and bequests, and similar expenses incurred solely to raise capital or obtain contributions are unallowable. Costs of investment counsel and similar expenses incurred solely to enhance income from investments are also unallowable. These activities, however, must be allocated an appropriate share of indirect costs.

Interest on debt incurred to finance or refinance assets before or reacquired after the effective date of this Circular is not allowable. However, debt incurred to acquire or replace facilities costing over $500,000 after the date of this Circular, and used in support of sponsored agreements is allowable, provided that a lease/purchase analysis shows that a financed purchase or capital lease is less costly to the organization than other leasing alternatives. Reimbursement is then limited to the least costly alternative.

**Lobbying: Not Allowable**

Lobbying activities include:

1. attempts to influence the outcomes of any Federal, State, or local elections, referendum, or similar procedure, through in kind or cash contributions, endorsements, publicity, or similar activity;

2. establishing, administering, contributing to, or paying the expenses of a political party, campaign, or other organization established for the purpose of influencing the outcome of elections;

3. any attempt to influence the introduction, modification, or enactment of legislation through communication with any member or employee of the Congress or State legislature or with any Government official or employee;

4. any attempt to influence the introduction, modification or enactment of any pending Federal or State legislation by preparing, distributing or using publicity or urging the public
to contribute to or participate in any mass demonstration, march rally, fundraising drive, lobbying campaign; and

(5) Legislative liaison activities, including attendance at legislative sessions or committee hearings, gathering information regarding legislation, and analyzing the effect of legislation, when such activities are carried on in support of or in knowing preparation for an effort to engage in unallowable lobbying.

Any lobbying activities carried out by an organization must be identified separately in an organization's indirect cost rate proposal.

**Maintenance and Repairs: Allowable**

Unless prohibited by law, the cost of utilities, insurance, security, janitorial services, upkeep, necessary maintenance, normal repairs and alterations, and the like are allowable to the extent that they: (1) keep property in an efficient operating condition, (2) do not add to the permanent value of property or appreciably prolong its intended life, and (3) are not otherwise included in rental or other charges for space. (Costs which add to the permanent value of property or appreciable prolong its intended life shall be treated as capital expenditures.)

**Materials and Supplies: Allowable**

The costs of materials and supplies necessary to carry out an award are allowable. Purchases should be charged at their actual prices after deducting all cash discounts, trade discounts, rebates, and allowances received.

**Meetings and Conferences: Allowable**

Costs associated with the conduct of meetings and conferences (including the cost of renting facilities, meals, speakers' fees, and the like) are allowable. If identifiable with a particular cost objective these costs should be charged to that objective. Costs of meetings and conferences held to conduct the general administration of the organization are also allowable.

**Memberships, Subscriptions, and Professional Activities: Generally Allowable**

An organization’s memberships in business, technical and professional organizations and subscriptions to business, professional, and technical periodicals are allowable. Allowable costs include costs (meals, transportation, etc.) of attending meetings and conferences where the primary purpose is the dissemination of technical information. The costs of membership in organizations substantially engaged in lobbying, however, are unallowable. Costs of membership in any civic or community organization are allowable with prior approval by the Federal cognizant agency, however, costs of membership in any country club or social or dining club or organization are unallowable.
Organization Costs: Unallowable, except with Prior Approval
Expenditures such as incorporation fees, fees to management consultants, organizers, attorneys, accountants, and the like, whether or not employees of the organization, in connection with establishment or reorganization of an organization, are unallowable except with prior approval of the awarding agency.

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

Preaward Costs: Allowable with approval
Costs incurred prior to the effective date of the award directly pursuant to the negotiation and in anticipation of the award are allowable only to the extent that they would have been allowable if incurred after the date of the award and only with the approval of the awarding agency.

Professional Service Costs: Allowable
Cost of professional and consultant services rendered by persons or organizations that are members of a particular profession or possess a special skill, whether or not officers or employees of the organization, are allowable, when reasonable in relation to the services rendered and when not contingent upon recovery of the costs from the Federal Government.

However, in determining allowability in a particular case, some of the factors considered relevant are: the nature and scope of service rendered in relation to the service required; the necessity of contracting for the service, the organization’s capability in the particular area; whether or not the service can be performed more economically by direct employment; and, the qualifications of the individual or concern rendering the service and the customary fees charged.

Profits and Losses on Disposition of Depreciable Property or other Capital Assets: Allowable, with exceptions
Gains and losses on sale, retirement or other disposition of depreciable property shall be included in the year in which they occur as credits or charges to cost grouping(s) in which the depreciation applicable to such property was included. The amount of the gain or loss to be included as a credit or charge to the appropriate cost grouping(s) shall be the difference between the amount realized on the property and the undepreciated basis of the property. However, gains and losses on the disposition of depreciable property may not be recognized in certain circumstances.
Publication and Printing Costs: Unallowable, except with prior approval
Publication and printing costs, including distribution, promotion, mailing, and general handling, are unallowable as direct costs except with the prior approval of the awarding agency. If these costs are not identifiable with a particular cost objective, they should be allocated as indirect costs to all benefiting activities of the organization.

Rearrangement and Alteration Costs: Allowable, some with prior approval
Costs for ordinary or normal rearrangement and alteration of facilities are allowable. Costs for special arrangement and alteration costs incurred specifically for the project are allowable with the prior approval of the awarding agency.

Recruiting Costs: Allowable, with exceptions
The costs of recruiting personnel, including travel costs of applicants for interviews for prospective employment, and relocation costs incurred incident to recruitment, are allowable to the extent that such costs are incurred pursuant to a well-managed recruitment program. Advertising costs and incentives, however, must be reasonable (i.e., ads can't be in color or of excessive size). Additionally, if a newly hired employee who received relocation costs resigns for reasons within his/her control within 12 months after being hired, the organization is required to refund or credit such relocation costs to the Federal government.

Relocation Costs: Allowable, with limitations and exceptions
Relocation costs are costs incidental to a permanent change of duty assignment (indefinitely or for at least 1 year) of an existing employee or upon recruitment of a new employee are generally allowable. These costs, which are typically limited by amount or time, can include such expenses as the continuing costs of ownership of the vacant former home after the settlement or lease date of the employee’s new permanent home (i.e., maintenance of buildings and grounds, utilities, taxes, and property insurance), closing costs incidental to the disposition of the employee’s former home; costs of canceling an unexpired lease (limited to three times the monthly rental), and costs of finding a new home, including temporary lodging. The following costs, however, are unallowable: (1) fees and other costs associated with acquiring a new home; (2) a loss on the sale of a former home; (3) continuing mortgage principal and interest payments on a home being sold; and (4) income taxes paid by an employee related to reimbursed relocation costs.

Rental Costs: Allowable
Rental costs are allowable to the extent that the rates are reasonable in light of such factors as: rental costs of comparable property, if any; market conditions in the area; alternative available; and the type, life expectancy, condition, and value of the property leased.
Rental costs under sale and leaseback arrangements or less-than-arms-length arrangements are allowable only up to the amount that would be allowed had the organization continued to own, or had title to, the property rented.

**Taxes: Allowable, with exceptions**

In general, taxes that the organization is required to pay and which are paid or accrued in accordance with GAAP, and payments made to local governments in lieu of taxes are allowable, except for: (1) taxes from which the organization could receive an exemption; (2) special assessments on land which represent capital improvements; and (3) Federal income taxes.

**Training and Educational Costs: Allowable**

The cost of training provided for employee development is allowable. These costs can include training materials, textbooks, salaries or wages of trainees, and salaries of the director of training and staff when the training program is conducted by the organization, and tuition and fees, and salaries or wages of trainees, when the training is not operated by the organization.

**Travel Costs: Allowable**

Travel Costs are allowable for expenses for transportation, lodging, subsistence, and related items incurred by employees and officers traveling on official business. Such costs may be charged on an actual cost bases, on a per diem or mileage basis in lieu of actual costs incurred, or on a combination of the two (provided the method used is applied to an entire trip, and results in charges consistent with those allowed in like circumstances in non-federally-sponsored activities). Generally, costs are reasonable and allowable only to the extent that they do not exceed charges normally allowed by the organization in its regular operations. Airfare costs in excess of the customary standard (coach) airfare, are unallowable except in certain circumstances.
OMB Circular A-133

OMB Circular A-133 “Audits of States, Local Governments, and Non-Profit Organizations” describes the audit requirements of nonprofit organizations that expend $300,000 or more in Federal funds in a fiscal year (see Note at beginning of this part). This limit applies to the expenditure of Federal financial assistance in the form of grants, loans, loan guarantees, property, cooperative agreements, interest subsidies, and insurance. A full copy of this circular is contained in Appendix E.

An A-133 audit involves much more than a detailed review of the nonprofit’s financial statements and financial controls (as in a standard financial audit, which was described in the previous chapter). It includes a testing of the nonprofit’s compliance with certain federal laws and regulations (such as OMB Circulars A-122 and A-110) and with the terms of its award agreement(s). For example, during an A-133 audit, auditors also look at program records to determine if amounts reported as expenditures were for allowable services, and the records show that those who received services or benefits were eligible to receive them.

A-133 audits of nonprofit organizations almost always fall into what is called the “single” audit category, which means that the audit covers all of an organization’s operations. This is as opposed to a “program” audit where only the records pertaining to a particular program are reviewed. Additionally, even though an organization may be exempt from A-133 (expending less than $300,000 in a year’s time), it still must make its records available for review or audit by appropriate officials of the Federal administering agency, the pass-through entity, and the U.S. General Accounting Office (GAO).

Under Circular A-133, an Auditee (the organization being audited) has the following responsibilities:

- The Auditee shall identify, in its accounts, all Federal awards received and expended and the Federal programs under which they were received. Federal program and award identification shall include, as applicable, the CFDA title and number, award number and year, name of the Federal agency and name of the pass-through entity.

- The Auditee shall maintain internal control over Federal programs that provides reasonable assurance that the Auditee is managing Federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its Federal programs.

- The Auditee shall comply with laws, regulations, and the provisions of contracts or grant agreements related to each of its Federal programs.

- The Auditee shall prepare financial statements that reflect its financial position, results of operations or changes in net assets, and where appropriate, cash flows for the fiscal year audited.
The Auditee shall prepare a schedule of expenditures of Federal awards for the period covered by the Auditee’s financial statements.

The Auditee shall ensure that the audits required under A-133 are properly performed and submitted when due.

The Auditee shall follow-up and take corrective action on audit findings, including a preparation of a summary schedule of prior audit findings and a corrective action plan.

In general, an A-133 Audit must answer the following questions:

- Do the financial statements of the organization present fairly its financial position and the results of its operations in accordance with generally accepted accounting principles?
- Are federal funds spent for allowable costs and in reasonable amounts? (see OMB Circular A-122)
- Does the organization have an internal control structure that provides reasonable assurance that it is managing Federal awards in compliance with applicable laws and regulations?
- Do reporting systems tell organization officials that federal funds have been spent in a timely manner?

Compliance with terms of the Federal Award

Unlike a financial audit, an A-133 audit must also assess an organization’s compliance with the rules and regulations of the Federal program for which it received funding. During an A-133 audit, the following areas may be assessed:

- Activities allowed or unallowed—did the organization carry out only eligible activities? (For instance, under the HOME program, funds may only be used for housing and housing related activities such as the rehabilitation or new construction of owner or rental housing, assistance to first-time homebuyers, tenant-based rental assistance, and site acquisition, site improvements, demolition, and other necessary and reasonable activities related to the development of HOME-eligible housing. Likewise, the CDBG program has a list of eligible activities which funds can be used for. Further, specific uses for funding are detailed in a Grant Agreement with the funding agency, which in the case of HOME and CDBG funds, is the Nebraska Department of Economic Development.)
- Allowable Costs/Cost Principles—did the organization use Federal funds for costs as allowed under the specific program or A-110? Did it pay a reasonable amount for these costs?
- Eligibility of beneficiaries—were the required eligibility determinations made and were the amounts of assistance provided to beneficiaries calculated correctly? (Here again, the
Federal program(s), along with the provisions of the contract or agreement between the funder and the subrecipient dictates income eligibility.

- Matching—if required, were funds declared as matching funds, meet the criteria for acceptable matching (verifiable, not used as match for other projects/programs, used for allowable costs, etc.)?

- Equipment and Real Property Management (pertains to equipment and property purchased with federal funds)—does the organization have policies and procedures to purchase, maintain or dispose of equipment obtained with Federal funds?

- Procurement Standards—does the organization have written standards of conduct and procurement procedures to ensure it is paying the most reasonable price for goods and services acquired with Federal funds?

- Period of Availability of Funds—did the organization incur costs only during the time period for which it received funding?

- Suspension and Debarment—does the organization have the required certifications from contractors for covered contracts and awards?

- Davis Bacon Act—did the organization document the Davis Bacon wage rate compliance of all contractors or subcontractors in any construction projects, if and when required?

- Program Income—how did the organization record, report, and use any program income it received?

- Real Property Acquisition and Relocation Assistance—did the organization undertake any activities that displaced persons from their homes or businesses? If so, did these persons receive equitable compensation for their property and relocation?

- Reporting Requirements—did the organization submit the required reports in an accurate and timely manner?

**A-133 General Requirements**

In addition to the review of financial statements, financial controls, and compliance with award terms, A-133 also calls for a review of compliance with several “General Requirements”. These requirements are generally part of any federal award or contract and must be in subrecipient agreements involving federal funds. These general requirements are:

- **Political Activity**: Federal funds cannot be used for partisan political purposes of any kind by any person or organization involved in the administration of federally-assisted programs.

- **Civil Rights**: No person shall, on the grounds of race, color, national origin, age or handicap, be excluded from participation in or be subjected to discrimination in any program or activity funded, in whole or in part, by federal funds.
Discrimination on the basis of gender or religion is also prohibited in some federal programs. Under the Fair Housing Act (covering discrimination in the sale or rental of housing, the financing of housing or the provision of brokerage services), discrimination on the basis of familial status is also prohibited.

- **Drug-Free Workplace:** The organization certifies that it will provide a drug-free workplace by the following methods:
  
  A. Publishing a policy statement notifying employees that the unlawful manufacture, distribution, dispensing, possession or use of a controlled substance is prohibited in the organization's workplace and specifying the actions that will be taken against employees for violation of such prohibition.
  
  B. Establishing an ongoing drug-free awareness program to inform employees about the following: the dangers of drug abuse in the workplace; the organization's policy of maintaining a drug-free workplace; any available drug counseling, rehabilitation and employee assistance programs and the penalties that may be imposed on employees for drug abuse violations occurring in the workplace.
  
  C. Making it a requirement that each employee engaged in the performance of a grant is given a copy of the drug-free workplace policy statement.
  
  D. Notifying the employee in the statement that as a condition of employment under the grant the employee will: (1) abide by the terms of the statement, and (2) notify the employer in writing of any criminal drug statute conviction for a violation occurring in the workplace no later than five calendar days after such conviction.
  
  E. Notifying the agency in writing within 10 calendar days after receiving notice as indicated in item D above from an employee or otherwise receiving actual notice of any criminal drug statute conviction for a violation occurring in the workplace.
  
  F. Taking one of the following actions within 30 calendar days of receiving notice of an employee's conviction as in D above:
    
    1. Taking appropriate personnel action against such an employee, up to and including termination; or
    
    2. Requiring such employee to participate satisfactorily in a drug abuse assistance or rehabilitation program approved for such purposes by a federal, state or local health, law enforcement or other appropriate agency.

A-133 Audits that uncover problems in controlling, spending or reporting on federal funds—called audit exceptions—can have negative consequences for an organization. Nonprofits that misspend funds can be required to pay back the funds. Nonprofits with audit exceptions can readily lose credibility with funders, financiers, board members, and supporters. An unqualified
(clean) audit is a necessity for nonprofits that want to use Federal dollars (see Part V. Audits for a definition of an Unqualified Audit Report).

**The Auditor’s Report under A-133**

An A-133 single audit report includes the following:

- The financial statements (Audittee’s responsibility to provide);
- A schedule of expenditures of Federal awards (Audittee’s responsibility to provide);
- Auditor’s opinions on the fair presentation of the financial statements and schedule of expenditures of Federal awards;
- Auditor’s report on internal control and compliance pertaining to financial reporting;
- Auditor’s schedule of findings and questioned costs;
- Audittee’s corrective action plans; and
- A summary schedule of prior audit findings which includes planned and completed corrective actions (Audittee’s responsibility to provide).

**Completing an A-133 Audit**

When required, it is the responsibility of the Audittee to arrange for and submit the A-133 audit report to the appropriate agency within the appropriate time frame. (Pass-through entities, however, also have responsibility for ensuring that their subrecipients have met A-133 Audit requirements.) The single audit report must be submitted to the Federal Audit Clearinghouse within thirty days of receipt of the auditor’s report, but no later than 9 months after the end of the audittee’s fiscal year. If the audittee is a subrecipient, it must also forward a copy of the report to any pass-through entity (i.e., in the case of HOME or CDBG funding, the Nebraska Department of Economic Development would be a pass-through entity).

Under the A-133 single audit process, the Audittee has the following responsibilities:

- Determining the total expenditures of Federal awards or assistance (it is the Audittee’s responsibility to ascertain whether or not it needs to comply with A-133).
- Selecting an Auditor to conduct the audit. This is probably the most important activity in the audit process, and the audittee is responsible for ensuring the auditor has the professional qualifications and technical abilities to conduct the audit. The United States General Accounting Office (GAO) has established general and specific continuing education requirements for Auditors. Overall, these standards require that Certified Public Accountants responsible for planning, directing, conducting, or reporting on audits should complete, every 2 years, at least 80 hours of continuing education and training which contributes to their professional proficiency (at least 20 hours should be completed in any 1 year of the 2-year period). Specifically, individuals responsible for planning or directing
an audit, conducting substantial portions of the field work, or reporting on the audit under A-133 should complete at least 24 of the 80 hours of continuing education and training in subjects directly related to the government environment and to government auditing. The auditing firm should maintain documentation of the education and training completed.

- Importantly, effective January 1, 2003, Amendment No. 3 to the GAO’s “Yellow Book” requires that audit organizations (auditors) be “free from organizational impairments to independence”. In this, the amendment expressly prohibits auditors who provide significant/material non-audit services to an organization from carrying out an A-133 Audit for that organization. These significant/material non-audit services are those that involve performing management functions or making management decisions. Examples of these include: maintaining an organization’s official accounting records; preparing, posting, and/or executing transactions (whether coded by management or not coded); making policy decisions; authorizing or coding transactions; and maintaining custody of an entity’s assets (i.e., bank account, etc.). An Auditor is required to notify the Auditee of any impairment to their independence.

- Preparing their organization’s financial statements, a schedule of expenditures of Federal awards, and a summary of prior audit findings (if any). The statements and schedule must be prepared for the same time period.

- Ensuring that the audit is properly completed.

- Submitting the single audit report when due. This means that the auditee must begin to arrange for the audit far enough in advance to ensure completion within the required timeframe.

- Taking corrective action on audit findings. The auditee must, when necessary, prepare a corrective action plan, take corrective actions on audit findings, and report the status of corrective actions in subsequent reports.

Importantly, an organization who will exceed (or even come close to) the A-133 threshold (at this time, $300,000), should, when contracting for an audit, inform its auditor that an A-133 audit is required or is a possibility. It is an extremely unpleasant surprise when an auditor who begins work on a “standard” financial audit, discovers that the auditee has exceeded the A-133 threshold. The additional auditing processes and requirements for A-133 not only add significantly to the cost of an audit, but to the time it takes to complete the audit.

**Note to Nebraska CHDOs regarding A-133 Audits:** Because CHDOs are not considered subrecipients under HUD regulations, they are generally not subject to A-133 audit requirements. However, in Nebraska, because the State itself is subject to A-133, it imposes the A-133 requirement on all CHDOs meeting the audit threshold in order to be able to document its own compliance.
Part VII. Building Your Organization

Many non-profit organizations find themselves in a Catch-22. They don’t have the staff, expertise, or time to attract the financial resources needed to grow and, as a result, they don’t have the funding to acquire the necessary staff and expertise that has the time to work on building the organization. Typically, organizations with limited staff must focus their energies on carrying out programs or projects, as required (and expected) by funding sources. This leaves little time for the doing the fundraising, carrying out the public relations activities, and forming the partnerships needed to strengthen and build an organization. Many organizations operate under a continual funding crisis.

Strategic Planning for Long-Term Growth and Stability

Hopefully, most non-profit organizations know what they will be doing in the next year, perhaps even the next two years. However, many nonprofits, don’t even try to look beyond this period. They don’t ask the question: “Will we be around in ten years?” Or: “What will it take for us to be around in ten years?” This type of “by-the-seat-of-your-pants” operation is stressful and often unproductive. One answer to looking at the long term is strategic planning.

Strategic planning is a creative process for identifying and accomplishing the most important actions in view of strengths and weaknesses, threats and opportunities. The process takes time, but it is time well spent and can have tremendous payoffs later on. Some of the most important benefits that can come from strategic planning are:

- It focuses attention on fundamental matters. While the day-to-day issues and problems of running programs and implementing projects is important, the long-term financial stability and health (and continued existence) of an organization is even more important if it hopes to carry out its mission.
- It creates consensus and a shared vision about the organization. Just working through the process can bring the board and staff together to work toward a common goal. If the broader community is involved in the process, it can also generate support for your activities.
- It puts you on a proactive, rather than reactive path. Strategic planning puts you in charge of your own destiny.
- It looks at all the angles. In this it provides an integrated picture of your current position and future prospects.
- It identifies the most effective use of resources. The process is designed to reveal those actions, policies, and investments that have the greatest positive impact on the future status of your organization. This means prioritization!
Strategic planning starts with **organization**. This means deciding who should be at the table during your process. For instance, should it be just your staff and board or do you want to invite other stakeholders to participate? Ask yourself who else is interested in your long-term viability. Ask them to be part of this effort. Once organized, follow a process. As undertaken in the for-profit corporate world, strategic planning generally takes the following steps:

1. **Assess your External and Internal “Environment”**: identify key factors, issues, needs, opportunities, threats, problems, and trends in your area and within your organization that impact your organization’s future existence.

   Look in depth at **outside forces** that affect or may affect your future. Look at regulatory and legislative changes, economic, demographic, social and political changes. For instance, how are the demographics of your area changing? What is the direction of the economy in your area or region? Is there a move in Congress or the state legislature to cut one of the programs that funds your organization? How will these things affect your organization overall?

   What are all the potential resources (human and financial) available to meet the needs you have identified? Who are all the potential stakeholders in your mission? Who are your biggest supporters? What is their future in the area? Who doesn’t provide support? Are there other organizations similar to yours operating in your area? Are there other entities, such as cities and counties, carrying out or interested in carrying out activities like yours? Do you have “competition” or are you competing for support or funding?

   Take an honest look at your organization from **the inside**. Make a complete listing of your strengths and weaknesses. Carry out an analysis of your current programs—your successes and challenges in implementing activities. Ask yourself, in light of your present and projected organizational needs, capabilities and resources, what must you have to continue as a viable organization? Areas for assessment could include:

   - Funding
   - Staffing
   - Facilities
   - Expertise (both organizational and programmatic)
   - Public Image
   - Accomplishments

   Also, how do you measure up against other organizations with similar missions? Assess your “reputation” in the area. How much “clout” does your organization have? Does the public-at-large and the “movers and shakers” know about your good work or do just your “clients” know about you?

   Try to answer the following questions: Should we maintain the status quo? Should we grow by adding new programs or increasing production of existing programs? How will
this affect staff and resources? Should we specialize in certain types of programs that match community needs, available resources, and staff skills? Should we contract out some of the activities we are doing to increase efficiency? Are there new partnerships we should be pursuing that can leverage our dollars and our staff skills?

2. **Select Key Issues:** On the basis of your assessment, choose the issues for which successful resolution is critical. These can be issues such as: “The housing needs in our area are significant, but we don’t seem to be capturing the same amount of funds that other areas with lesser needs are.” “The people living in the town where our office is know us, but hardly anyone in the rest of our service area does.” “We are in a constant cash flow crisis.” “We didn’t do a very good job of administering our first two programs, now our funders are reluctant to give us more money.” or “Our last audit wasn’t too good, now what do we show prospective funders?” “We are too reliant on one entity for funding!”

3. **Set Broad Goals:** Establish the direction for your strategy development process by setting general goals. A goal should do one or both of the following: lessen or negate the impact of the problems/issues pinpointed in your assessment and/or build upon strengths and opportunities identified. Goals should identify what your organization would like to accomplish, while objectives (see Step 4) further quantify the goal. For instance, goals could include such things as: “Stabilize and broaden funding base or increase sources of income” or “Increase public awareness of our overall mission and activities.” or “Reduce overall administrative costs.” or “Increase staff capacity and expertise in order to improve overall management of organization and provide or expand services.” or “Secure quality, affordable professional expertise in financial management.”

4. **Develop Objectives and Strategies:** For each of your broad goals, establish measurable, achievable objectives and preliminary strategies on how each of these objectives can be achieved. Each strategy should have a “sketch” plan for implementation, with a timetable, identification of resources needed, and assignment of who would be responsible for carrying it out.

5. **Prioritize and Refine Strategies:** Here’s the most strategic part of strategic planning. Evaluate your preliminary outline of strategies. Upon further consideration, decide which need to be or can be done first. The criteria for prioritizing strategies often depends on the nature of the goals to be achieved, factors such as financial and human (expertise, time, etc.) resources available to carry out the strategy, likelihood of success (feasibility), cost effectiveness (“bang for the buck”), long-term benefits, and impact.

6. **Finalize Implementation (Action) Plan:** For each strategy selected there should be a detailed plan for who is responsible for carrying it out, when it should be done, and how it will be paid for (if there are costs). One way to do this is to include a month-to-month
calendar showing what is expected to happen (milestones to be reached) at each point in the implementation process.

7. **Monitor, Update, and Scan Again:** Successful strategic planning requires the continuous review of actual accomplishments in comparison with the plan. (Someone or a group of “someones” in the organization also needs to be assigned to do this task.) Ensure that strategies are carried out. Adjust them as necessary in a changing environment. Be prepared to update the plan when major changes occur in your environment.

Strategic planning also serves another important function: as with financial management, it is a message to investors, both existing and potential, that the organization is a healthy one, is looking to its future, and can spend the public’s money efficiently and effectively. It can also clearly make the case for a continuous, dependable supply of funding for the long term.

**Finding Investors**

It would be extremely rare for an organization to complete a strategic planning process that did not identify the need for increased funding, or the stabilization of funding, as an important (strategic) issue for its long-term viability. The most successful and long-lived organizations devote significant time to gaining new investors (funders). Larger organizations have full-time grantwriters and fundraisers on their staff. Money raised by these organizations focuses on two areas: general organizational expenses (including more fundraising expenses) and program or project-related expenses.

Obviously, the more diverse an organization’s funding base, the more secure an organization will be. A single funder never wants to be relied on as a sole and/or continuous source of funding to an organization. This is especially true when it comes to general organizational support. Investors generally don’t want to pay your rent and your light bill. They want to invest in bricks and mortar, increasing homeownership, feeding the homeless… in something they can put on their own “public balance sheet”. While they realize that if an organization can’t pay its people, rent, etc., it can’t carry out its mission, they still want to be able to point to something they invested in. This is why it is critical for an organization to have its own “public balance sheet”, or track record for good work, and to market this track record so that investors become interested and stay interested. With a strong public balance sheet, an investment in an organization’s general operations becomes an investment in its projects and programs.

In smaller organizations, the job of fundraising and the public relations and marketing activities required to increase funding through contributions and donations usually falls to the executive director. In an extremely small organization, where the executive director generally shoulders the responsibility for all aspects of the organization, the board needs to be actively involved in helping the staff to develop a funding base. Successful fundraising requires a
multitude of activities (research, proposal writing, making presentations, developing marketing materials, and more), and a lot of hard work. Match different fundraising activities with the skills of individuals (board members and staff) in your organization.

Most non-profit organizations depend, to some degree, on “public” support--direct grants or other assistance provided by government entities. However, before we proceed with this discussion, let’s define the term “Investors”. Simply put, an investor is someone (or some entity) who gives you something in order to earn or gain something.

➢ What is the “something” that an Investor can give you? Well, at the top of the list is money, either granted or loaned. However, there are other contributions an Investor can make: buildings or land, volunteer time and/or expertise, donated materials, space, and/or staff time.

➢ What is the “something” that an Investor wants to earn or gain? In order to answer this question, we must look at the investor’s motive for investing. Here, a variety of factors can come into play and sometimes an investor may have more than one motive or reason for investing. For instance:

   q Some investors want a financial return on their investment (i.e., loan payments with interest, tax deductions, etc.). This primarily the case with for-profit entities, such as financial institutions. After all, they are in the business to make money so they can make more loans. This would also be the case with investors who provide equity to affordable housing projects in return for the tax credits that receive from such investment.

   q Some investors want (or need) you to help them meet their mission, their “reason for being”. This is an over-riding concern of government entities and private foundations. For instance, government agencies want to fund successful projects that help a lot of people that will strengthen their case for continued funding from Congress (or the state legislature). Private foundations generally emphasize certain types of projects that they will fund, usually based on donor wishes.

   q Some investors want (or need) the “good press” that helping you will give them. Anonymous donors are rare. While it’s always good public relations for an investor to contribute to a worthwhile project, there can be situations where good press may be critical to an investor. One example of this is a financial institution that needs to improve its community reinvestment rating.

   q Some investors are primarily interested in the “spin-off” effects that your organization’s projects or programs may have on other things. For instance, entities interested in improving an area’s economy may see providing assistance to a housing nonprofit as a way to support this effort.
Some investors may get personal satisfaction from helping your cause. This is usually the case with private individuals who donate money, time or expertise to an organization. They believe that your mission is a good one and feel good by helping.

There are also other factors that influence an investor's decision to invest. Some want to make only no or low risk investments, some may want control of some aspect of your program, some may even be acting from a personal point-of-view (i.e., their job depends on their making a loan).

Who are Investors?

Who are the entities that invest in nonprofit organizations? One way to categorize them is as follows:

1. Governmental and quasi-governmental—federal, state, regional and local;
2. Private entities, including other non-profit organizations (i.e., foundations) and for-profit businesses, such as banks, Chambers of Commerce, etc.; and,
3. Individual charitable donors.

Even within these groups, funders come in all “shapes and sizes”. Let's look a little more closely at these entities. There are:

- Federal government investors, which come in the form of Federal agencies, such as the U.S. Department of Agriculture Rural Development (USDA/RD); the U.S. Department of Housing and Urban Development (HUD); the U.S. Department of Health and Human Services, the U.S. Department of Commerce, and others. Financial support from these entities can be either direct (as in the case of a Supportive Housing Program Grant directly from HUD), or via a pass-through entity, which is the case with CDBG and HOME funding that reaches organizations through the Nebraska Department of Economic Development. Support from these entities can be in the form of grants, loans, and, importantly, technical assistance.

- State government investors, both public and quasi-public. For housing and community development activities in Nebraska, the primary agencies/organizations are the Nebraska Department of Economic Development and the Nebraska Investment Finance Authority, which provide both funding and technical assistance. While the focus of these two entities is on funding projects and programs, DED also provides operational support to nonprofit organizations and both DED and NIFA have provides pre-development funding for projects. In addition to administering the state's allocation of CDBG and HOME funds, DED also administers the state-funded Affordable Housing Trust Fund. (The Nebraska Department of Health and Human Services administers the state's allocation of Emergency Shelter Grant monies and the state-funded Homeless Shelter Assistance Trust Fund--other
sources of funding for nonprofits.) NIFA’s assistance is primarily in the form of bond financing and allocation of the State’s Low Income Housing Tax Credits.

- Regional investors include public power districts and economic development districts. Both of these entities are primarily focused on economic development, but both realize that an area without adequate housing will have a difficult time building its economy. Economic development districts, however, also may administer housing programs and therefore can be a source of competition for housing nonprofits.

- Local government investors include cities, towns, and counties. Communities can provide assistance with tax increment financing (a source of funds to complete the public improvements associated with developments), through exercising a local option to increase sales taxes that fund community development activities, land donation and other mechanisms.

- Private investors are numerous. Examples are:
  - Local lenders that will access programs of the Federal Home Loan Bank of Topeka or provide loans with guarantees from Federal government agencies
  - Local lenders that will make favorable loans to meet CRA obligations or that have or can access bank foundation monies
  - Local businesses, including local Chambers of Commerce
  - Private entities that provide equity to housing projects in return for tax credits or even loan money for projects (one example of this is the Mercy Loan Fund).
  - Private foundations: national, statewide, regional, or local (many communities have their own foundations)
  - Private individuals who will donate money, time, expertise and more

What do Investors need to know?

Investors want, first and foremost, to be assured that an organization is going to stay in business. They want to see more than a marketing brochure. They want to see your plan; they want to see a budget that matches that plan; they want to know that your public “balance sheet” is a strong one, and they want to know that your financial house is in order.

Continued public support depends on continued public trust. That trust can be gradually undermined by instances of fiscal irresponsibility and mismanagement. Investors may want to see your financial statements, audits, and tax returns. While truthful, accurate, and timely
financial reporting, as described in this Primer, is one of the most important ways an organization can fulfill its obligation of accountability to its investors and the public, it is also one of the most potent ways an organization can “tell its story” and justify its tax-exempt status.

Investors may want to tour your projects (actually a tour may be a good idea), hear testimonials, get references, and review qualifications of staff that will carry out the project. What is your organization’s track record?

In addition to knowing that your financial house in order and that you have based your activities and budget on a thoughtful strategic plan supporting your mission, what else do investors focus on?

- For government investors the emphasis is primarily on compliance. While they are concerned with performance, they are more interested that a nonprofit is following the statutes and regulations of the federal funding source and OMB circulars.

- For foundations and charitable investors, performance is very important and the only compliance issue they focus on is making sure the organization is a 501(c)3.

Lastly, Investors want results. They want to see a “product”. They want to know that their investment turned into a successful project, and that they made a difference somehow.

**Partnering to Enhance Capacity and Reduce Risk**

Another way a nonprofit organization can strengthen its operations is to form partnerships with others. Because the word partnership implies a sharing or joining together for mutual benefit or benefits, a partner is not typically an investor, although the line between partner and investor is sometimes blurred. Importantly, many of the same entities on your “list” of potential investors should or could also be among your potential partners. Partners may also have the same motives for entering a partnership as investors do in investing.

Potential partners can generally be divided into two categories: general organizational partners and program/project partners. Organizational partners are those that can help you carry out your overall mission. Program/project partners are those that can help you carry out specific programs or projects. The most important activity an organization can and must perform in finding and evaluating potential partners is to identify its own strengths and weaknesses (as done during the strategic planning process) and those of its potential partners in order to sort out roles and responsibilities each could assume. There are numerous advantages to forming partnerships. Included in these are:

- Reduced overall organizational expenses from sharing staff, sharing office space and/or equipment, etc.
Lowered costs or expanded programs and services by combining staff and expertise

Increased ability to secure funding by creating a broader base of support (yours plus your partner’s) and improving your “marketability” to funders/investors

Expanded assistance to your clientele in accessing additional programs

How does an organization find Partners?

First of all, potential partners will generally be entities that operate within, or close to, your organization’s area of operation. (It’s difficult to have long-distance partnerships.) Identifying these partners was hopefully done during the first stage of your strategic planning process. At this time an organization:

- Identifies other entities in its area that could be stakeholders with it in its mission. For instance, if a nonprofit’s mission is to provide affordable housing, the community (government), region, local merchants and employers, the Chamber of Commerce, local lenders, etc. could all benefit if it succeeds; and,

- Determines if there are there other organizations similar to it (for example, non-profit, human-service or housing-related) and geographically close enough to form partnerships with. (Public housing authorities would fall in this category.)

Forming partnerships may require a good deal of finesse, marketing and self-promotion. An organization also needs to use salesmanship and take the time needed for this “courtship”. Even the smallest organizations have something to offer a partner, although this may not always be readily apparent.

For example, a small nonprofit wants to apply for funding to carry out a first time homebuyer program. Because it is short on staff, it approaches a local lender and asks it if it would be interested in providing underwriting services for the program. Bank staff, with expertise in this area, could provide this service, and in return, the bank could get CRA credits, and increase its loan portfolio by also providing a conventional loan on the project. In this partnership the organization is reducing their costs and increasing their efficiency and the bank is making more loans and as a spin-off, strengthening the local economy (in turn, more loans, deposits, etc.). Everyone benefits.

Making that first phone call to identify the right organization and the right person in that organization to approach is often is the hardest step. Brainstorm with your board and supporters. Who do they know, or who do they know that knows someone, etc. Determine who is the best person from your organization to take that step and develop a strategy for approaching them. Explain the mutual benefits that could come from a partnership and
describe how you see the partnership working (who does what). Take care, however, not to step on anyone’s toes. Partners work together for mutual benefit.

And lastly, be open to opportunities. Sometimes partners will come to you. For instance, private for-profit developers who build affordable housing generally need non-profit organizations as partners. Local governments with affordable housing as a community development goal/strategy also will look for someone to sponsor/develop this housing.

**Establishing Partnerships**

Establishing a partnership can be formal or informal. It’s best, however, if the roles and responsibilities of each partner are clear at the outset and set forth in a written agreement. Some written agreements can be more formal than others, ranging from Memoranda of Understanding to legal contracts. For instance, a partnership with the local government to work together to develop affordable housing could be set out in a Memorandum of Understanding. (Will the “city” help to find land, provide infrastructure, etc.?) In the extreme, a partnership to merge with another non-profit organization most likely would require re-incorporation, and new Articles of Incorporation and by-laws.

Partnerships with private developers may also need to be more formal. In this instance, it is incumbent on an organization to understand the tax credit process and establish at the outset of the process the exact role you will play (is it “smoke and mirrors” or is the organization a working partner?). What payment will the organization receive from the project? Will the organization assist the developer in overseeing construction? Will it provide management services to the project? Etc.

Unfortunately, even forming partnerships cannot address all the resource limitations facing small nonprofit organizations. All organizations have to make choices, put those choices in priority, and set realistic goals about their activities. This underscores the importance of strategic planning.

**Generating Income**

While nonprofit organizations will always need investors and may always be able to benefit from partnerships, it is indeed the fortunate nonprofit organization that can generate enough income to become both self-sufficient and provide for its own growth. As discussed in previous parts of this Primer, nonprofits by definition do not exist to make a profit. This does not mean, however, that an organization must “break even” each year. It is entirely acceptable, even desirable, for a nonprofit to generate income and accumulate Net Assets that, in turn, can (and must) be used to support their activities and further their overall mission.
Hopefully, the needs assessment and resource inventory carried out at the start of the strategic planning process has also identified potential areas where the organization can establish programs or projects, or provide services, that will generate income for itself. There are numerous examples of this:

- An organization could determine that it has some staff resources available to take on additional activities (i.e., its own in-house program does not require a full-time person). It also determined that some communities in its area are interested in applying for housing rehabilitation funding from the state but don’t have the technical expertise (or familiarity with regulations) to carry this out themselves. The organization could approach the local governments with a proposal to administer the program.

- A nonprofit that has entered into a partnership with a for-profit developer to build affordable housing could provide on-going maintenance and management for the project once it is developed. This activity might require additional training for staff in this area, and probably the subcontracting of repair services.

- An organization could operate its own program to build homes for first time homebuyers, retaining the profit from each home to build more houses.

The income generating activities described above essentially provide an immediate payoff. Other activities aren’t so quick in their return. This is especially true of housing development, where a nonprofit’s involvement as a partner in the project, and its eventual “profit” from income generated by the project are many years down the road.

In the previous examples it could be said that the city that signs a contract with a nonprofit to administer a program is both investing in that organization and partnering with it, and that the for-profit developer is doing the same. The truth in this is that developing activities that generate income also requires an organization to have the same solid track record, the same guarantee that it will stay in business, and to carry out the same types of marketing and public relations activities as required to secure investors and establish partnerships.

INTRODUCTION

The attached sample CDC Policies and Procedures Manual was developed by the Local Initiatives Support Corporation (LISC) to assist community development corporations (CDCs) in their administration of federal funds. The manual, which includes sample personnel, accounting, financial management, procurement, and records management policies, has two distinct purposes:

1. To provide emerging CDCs with sample policies and procedures so that they may be able to develop policies and procedures appropriate to their specific circumstances, and to provide their staff members with information regarding the type of systems that may be adopted in their administration of federal funds; and

2. To provide mature CDCs with sample policies and procedures to compare with their existing manual and assess whether adequate systems are in place particularly with respect to the administration of federal funds.

Please note: the sample policies and procedures presented in the attached manual are provided only as examples and for reference purposes only. In many instances, a CDC’s existing policies and procedures manual may suffice. Prior to developing a policies and procedures manual or adopting any of the sample policies and procedures attached, LISC strongly encourages any organization to consult with its legal counsel, accounting, financial and/or human resource professionals. By doing so, this will assist the organization in developing policies and procedures that reflect its organizational philosophy and that are appropriate to their specific circumstances and that are consistent with applicable state and local laws. In addition, please remember that this is only one of many possible models that could meet the federal regulations. These are resource materials: LISC makes no legal representation concerning the adequacy of these policies and procedures or their compliance with federal, state or local laws.
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Section Two: Sample Personnel Policies and Procedures

The Board of Directors of Nonprofit Organization ("NONPROFIT") have developed and enacted the following personnel policies and procedures by virtue of the by-laws of the organization. These policies and general operating procedures were enacted and are being adopted for the effective operation of NONPROFIT. The day-to-day functional implementation of these policies and procedures is the responsibility of the Executive Director of NONPROFIT.

The purpose of these policies and procedures is to serve as a reference tool in making decisions involving the management and operation of NONPROFIT; to establish guidelines to be followed by the Executive Director in determining employment practices; and to acquaint employees with their general employment rights, benefits and responsibilities. The manual will also provide employees with information on NONPROFIT’s policies and procedures with respect a drug-free work environment.

These policies and procedures may be amended through the Board of Directors on recommendation of the Executive Director and/or the Executive Committee. Organizational policies and procedures should be reviewed on a periodic basis by the Executive Committee to determine if any changes are necessary.

I. Policy on Affirmative Action

It is the policy of NONPROFIT that it will operate and conduct business without discrimination or segregation because of age, sex, race, color, religion, national origin, or handicap, except where there is a bona fide occupational qualification for the job tasks to be performed.

II. Employment

All positions not filled by internal promotion of existing employees will be advertised, and all applicants will be considered for employment in compliance with all applicable federal, state and local laws.

A. Hiring

The Board of Directors has the responsibility of hiring the Executive Director upon recommendation of the Executive Committee, which will interview and screen applicants. The Executive Director, with consultation of the Executive Committee and appropriate staff, has the responsibility of hiring all other staff.

B. Termination

The Board of Directors has the responsibility for the termination of the Executive Director upon recommendation of the Executive Committee in accordance with these policies. The Executive Director, with consultation of the Executive Committee, has the responsibility to oversee the termination of all employees in accordance with these policies.
III. Employment Status

A. Employment At Will

Employees hereby understand and acknowledge that, unless otherwise defined by applicable law, any employment relationship with NONPROFIT is of an “at-will” nature.

B. Full-time

A full-time regular employee is one who works between 33 and 40 hours per week.

C. Part-time

Part-time employees are staff members who work less than full-time in a regular job slot.

D. Consultants

Consultants are contracted for a specific scope of work and/or time period and are not employees of NONPROFIT.

IV. Work Schedule and Pay Periods

A. Work Schedule

All full-time employees typically work a 40-hour, five-day week including meal breaks. The normal office hours of the organization are Monday through Friday from 9:00 a.m. to 5:00 p.m. Employees will be paid time and one half for each hour worked beyond 40 each week or will be awarded compensatory time at a rate of one hour for every hour over forty worked during a single week.

B. Time Sheets

All employees shall be required to complete time sheets on a weekly basis. Employees whose salary is funded from multiple federal, state or local sources are required to allocate their time accordingly to the various funding sources on their time sheet.

C. Pay Period

Employees will be paid on a bi-weekly cycle. Wage changes will be made once per year after annual evaluations have been completed in conjunction with the preparation of the annual operating budget.

V. Benefits

A. Insurance Retirement

NONPROFIT provides a benefit package to all full-time employees which includes:

1. Individual or Family Health Insurance
2. Short and Long Term Disability
3. 403b - retirement
B. Personal Sick Leave

Personal sick leave will be accumulated as follows: 5 days at one year of service, 8 days at three years of service, and 10 days at 5 years of service. Any unused sick leave will be forfeited at year’s end. All accumulated sick time is also forfeited upon termination of employment for any reason.

C. Bereavement

Five working days of paid bereavement leave will be granted to employees who have a death in the immediate family. The immediate family is defined as grandparents, parents, children, spouses, domestic partners and siblings.

D. Leave of Absence

Employees may request an unpaid leave of absence that must be submitted in writing to the Executive Director. Granting of such leave is at the discretion of the Executive Director except in such cases where granting of leave is required by law, such as the Family Medical Leave Act.

E. Vacation

Vacation will be accumulated as follows: 2 weeks vacation during the first year after 6 months of employment, 3 weeks per year after five years of service, and 5 weeks per year after eight years of service. Vacation time can be taken at any time with approval of an employee’s immediate supervisor. Employees may accumulate up to 30 days of vacation time. Employees will be paid for accumulated vacation time at termination of employment.

F. Disability Leave

A disability leave of absence should be requested in writing and should be submitted to an employee’s immediate supervisor as soon as practical and with a doctor’s recommendation and medical documentation. The request should indicate the date on which the employee will stop work and a projected return date. NONPROFIT will hold the job, or one at the same level of any employee on disability leave for a period of up to six months.

After the employee’s sick leave is exhausted, vacation and/or compensatory time may be used for continued absence.

The employee will contact their immediate supervisor as soon as possible regarding their intentions to return to work or not, following an absence due to illness.
Pregnancy will be considered a temporary medical disability for purposes of this document.

A leave of absence for disability purposes will not constitute a break in tenure for purposes of calculating length of service; however, no additional sick leave or vacation time will be accumulated during the absence.
G. Military Service

Full-time, regular employees who are inducted in the Armed Forces are considered to be on leave of absence without pay and accrue only those benefits specified by law. Upon completion of military assignment, the employee is eligible for rehire in their former job or a job of similar status and pay providing the following conditions are met:

1. The employee must have been employed in a position other than temporary before their induction;
2. They must have left their job to enter military service;
3. They must have received certificate(s) of satisfactory completion of military service;
4. They must apply for re-employment within 90 calendar days of their discharge; and,
5. They must be able to perform the duties of their former job or a job of similar status.

Veterans will be re-employed with the same seniority, status, and pay they would have had if they had not entered military service.

H. National Guard/Reserves

Staff members who are members of the National Guard or the Reserve will be granted a leave of absence for any period or required service with their unit other than normal tour duty. All benefits will accrue during such periods and such duty will not be considered a break in service. The employee must be reinstated in their position providing they meet all of the conditions listed under Military Service (Section G) with the following exception:

The employee must report to work at the beginning of the next regularly scheduled working period following their release from duty.

Employees who must take time off to participate in the Reserve or National Guard must submit a written request for leave to the immediate supervisor indicating the period of absence and the expected return date.

VI. Holidays

The following paid holidays will be observed:

1) New Year’s Day 6) Labor Day
2) Martin Luther King, Jr. Day 7) Columbus Day
3) President’s Day 8) Veteran’s Day
4) Memorial Day 9) Thanksgiving
5) Independence Day 10) Christmas Day
VII. Supervision and Evaluation

The Chairman of the Board of Directors is the direct supervisor of NONPROFIT’s Executive Director, and in conjunction with the Executive Committee of the Board of Directors, will conduct an annual performance evaluation of the Executive Director. The Executive Director is the direct supervisor of each individual employee. Program Directors are the direct supervisors of the support staff in their program.

A. Annual Evaluation

All employees will be evaluated by their direct supervisor, using established standards of performance for their position, on an annual basis. The employee’s anniversary date will be revised to be the same as the budget year, for budget and funding purposes only.

B. Initial Evaluation

The immediate supervisor or the Executive Director (see above) will perform an evaluation, three months after employment with the organization begins.

VIII. Resignation, Suspension, Termination, Reduction

A. Resignation

Employees who wish to resign from their positions will give two weeks written notice to their immediate supervisor with the reasons stated therein. If two weeks notice is not given before resignation, the employee may lose any accumulated vacation time or other benefits.

B. Suspension

An employee may be suspended by the Executive Director without pay for breach of client confidentiality, unsatisfactory job performance, and/or just cause. The Executive Committee must review the facts of the case at or before the next regularly scheduled board meeting to either confirm or reverse the suspension. The decision of the Executive Committee will be given in writing.

C. Termination

Dismissal will be for unsatisfactory job performance, violation of the Personnel Policies and Procedures, illegal acts, or any other just cause as determined by the Executive Director. Written notice of termination will be given with reasons for the action stated to the employee. Immediate termination will occur for breach of client confidentiality, theft, and/or just cause. A disciplinary conference will be held prior to termination for unsatisfactory performance. Unsatisfactory job performance includes, but is not limited to excessive absenteeism, tardiness, failure to cooperate with other employees, and unauthorized use of company property.

D. Reduction

If an employee must be terminated due to a reduction in workforce, he or she will be notified 30 calendar days prior to the event.
IX. **Travel and Other Expenses**

Employees will be reimbursed for travel and expenses provided the trip is pre-approved by the employee’s immediate supervisor. Employees using personal automobiles for travel will be reimbursed at the current IRS approved rate. All requests for mileage reimbursement will be documented on the approved mileage reimbursement form.

X. **Conflict of Interest**

1. No employee will participate in activities or other employment that cause a conflict of interest with the activities of NONPROFIT. Activities or employment that create possible conflicts will be disclosed to the Executive Director in writing for review.

2. Any employee of the organization, who accepts gifts or gratuities from individuals, companies, clients, or suppliers in conjunction with their job, will be subject to disciplinary action up to and including dismissal.

3. No NONPROFIT employee is to become involved in real estate development, outside of his or her work at NONPROFIT, in any neighborhood where NONPROFIT operates a program.

4. No officer or employee may serve as an official, director, or trustee of any for-profit or non-profit enterprise without obtaining the approval of their immediate supervisor.

5. NONPROFIT encourages service with constructive and legitimate not-for-profit organizations. Participation in civic affairs is encouraged as part of our commitment to community involvement. There are cases, however, in which organizations have business relationships with the organization in which the handling of confidential information might result in a conflict of interest. An employee’s immediate supervisor must be advised when a potential conflict exists.

XI. **Policy Prohibiting Unlawful Harassment, Including Sexual Harassment**

It is the policy of NONPROFIT that it will not tolerate verbal or physical conduct by any employee which harasses, disrupts, or interferes with another’s work performance or which creates an intimidating, offensive, or hostile environment.

As an equal opportunity employer, it is NONPROFIT’s policy that every applicant and employee shall enjoy a work environment free from all forms of unlawful harassment, including sexual harassment. Unwelcome verbal, physical or visual conduct involving any individual’s race, color, religion, sex, sexual orientation, pregnancy, age, national origin, ancestry, citizenship, medical condition, physical disability, marital status, or military service, or any other basis protected by any federal, state or local law which impairs an employee’s ability to perform their job is illegal and is strictly prohibited.

Sexual harassment is an unlawful employment practice under Title VII of the Civil Rights Act of 1964 and various state laws. The regulations of the Equal Employment Opportunity Commission define “sexual harassment” as follows:
Unwelcome sexual advances, requests for sexual favors, and other verbal or physical conduct of a sexual nature constitutes sexual harassment when:

(1) submission to such conduct is made either explicitly or implicitly a term or a condition of an individual’s employment;
(2) submission to or rejection of such conduct by an individual is used as the basis for employment decisions affecting such individual; or
(3) such conduct has the purpose or effect of unreasonably interfering with an individual’s work performance or creating an intimidating, hostile or offensive working environment.

Some examples of sexual harassment include, but are not limited to, the following:

- Unwelcome requests for sexual favors or dates.
- Unwelcome physical touching.
- Jokes or gestures that have a sexual content or sexual connotation.
- Posters or cartoons that have a sexual content or sexual connotation.
- Sending or forwarding written or electronic correspondence of a sexually explicit nature.
- Creating an otherwise offensive working environment or unreasonably interfering with another’s ability to perform his or her job.

NONPROFIT does not condone sexual relationships between supervisors and their staff. A relationship of this type can easily be considered sexual harassment. If such a relationship develops, one of the individuals must transfer to another position in the organization.

Both as a matter of law and common decency, each employee of NONPROFIT is entitled to pursue his or her employment, free of harassment or discrimination on any of the prohibited bases enumerated above. Accordingly, unlawful harassment or discrimination against any employee of NONPROFIT will not be tolerated. Violation of this policy may subject an employee to discipline, up to and including immediate termination.

Any employee who believes that he or she (or another employee) is the object of harassment or discrimination on any of the above-enumerated bases is strongly encouraged to follow the complaint procedure outlined below.

Any employee may initiate the complaint procedure, without fear of reprisal, by immediately reporting such complaints to the:

- the employee’s immediate supervisor.
- the Director of Human Resources, if the employee feels that he or she is unable to report a complaint to his or her immediate supervisor.
- an officer of NONPROFIT, if the employee feels that he or she is unable to report a complaint to the Director of Human Resources.
NONPROFIT takes all complaints of harassment or discrimination seriously. All complaints will be investigated immediately by an impartial designee to be determined by senior management of NONPROFIT.

Any employee who believes that the actions or words of a supervisor or fellow employee or some other person(s) encountered in the workplace constitute unwelcome harassment has a responsibility to report such incident as soon as possible to the appropriate supervisor, manager or officer of NONPROFIT. Employees are encouraged to utilize the foregoing complaint procedure. No employee will be retaliated against for having opposed unlawful harassment or discrimination, or for having filed a complaint or otherwise participating in an investigation concerning a complaint.

Employees are also notified that there are governmental agencies that handle claims of unlawful discrimination and harassment. These agencies include the Equal Employment Opportunity Commission and the Nebraska Equal Opportunity Commission.

Each employee will be required to sign an acknowledgment of the Policy Prohibiting Unlawful Harassment, Including Sexual Harassment contained at the back of this manual.

XII. Personnel Files and Employment Information

All staff members have a right of access to their personnel file, with the exception of access to reference checks that were obtained in confidence. The staff member may review the folder in the presence of their immediate supervisor. It is the responsibility of the staff member to provide information to their supervisor to keep personnel folders up-to-date (e.g., current resumes, change in marital status, name, address, telephone numbers, number of dependents, designated beneficiaries, education and training skills).

The employee’s immediate supervisor is authorized to verify the following information for a prospective creditor of an employee: (1) dates of employment; (2) title; and, (3) salary. Neither the Executive Director nor any employee is authorized to provide a prospective employer of a present or former employee of the organization with any information other than dates of employment and title.
SECTION THREE: Accounting, Audit and Financial Management Policies

I. Accounting Policies

It shall be the policy of the CDC to create and maintain accounting, billing, and cash control policies, procedures and records which are consistent with Generally Accepted Accounting Principles (GAAP) and which meet the requirements of state and federal statutes and regulations.

CDC accounting, audit, and financial management policies are designed to:

1. Protect and secure the assets of the CDC.
2. Ensure the maintenance of accurate records of the CDC’s financial activities.
3. Ensure compliance with governmental and private funder reporting requirements.

A. Cash

1. Bank accounts are established as required by donors and funding requirements.
2. All checks written on CDC accounts require two signatures.
3. Individuals generally authorized to sign checks include the President, Vice-President, and Treasurer of the Board along with the Executive Director of the CDC. All persons approved to sign checks will be formally approved by the CDC’s Board of Directors.
4. The Executive Committee authorizes all bank accounts and approves all check signers. The approval of signers shall be reflected in the Board of Director’s meeting minutes.
5. Banks are promptly notified of all changes of authorized check signers.
6. All checks are to be pre-numbered and accounted for by a check custodian (used, voided, not used).
7. Voided checks are to be properly defaced and maintained.
8. Bank reconciliations to the general ledger are to be done monthly and provided to the Executive Director or Treasurer at their regular meeting.

B. Petty Cash

1. Receipts or itemized slips are required for every disbursement. The Executive Director or his/her designee will be responsible for verification of receipts and cash.
2. Petty cash should be used for such things as small and odd jobs, local travel and sundry items. It is not intended for purchases that can be made with designated suppliers. Activities or needs should be planned ahead so necessary funds will be available in the petty cash account.
Whenever petty cash is used, a pre-numbered “Receipt of Petty Cash” slip must be filled out. A completed slip will include date, the amount taken and returned, the cash category and the total spent. When a staff person receives cash, he/she will sign on the “Received By” line of the petty cash log. Items purchased should also be listed on the log, unless the receipt that must always be clipped to the log lists items purchased. The Executive Director or his/her designee will sign on the “Approved By” line of the petty cash log.

The Finance Officer will be responsible for the reconciliation and replenishment of the petty cash account.

C. Cash Receipts

(1) Someone other than the person making deposits is responsible for opening the daily mail, making a log of cash receipts, restrictively endorsing the payment, making note of any restrictions on the log entry, and account coding the receipt by receivable or revenue account.

(2) The Executive Director prepares bank deposit slip, listing each item.

(3) Receipts are deposited daily. The bank’s stamped duplicate deposit slip is attached to the remittance documentation.

(4) The daily deposit log and duplicate deposit slip is forwarded to the Financial Officer for verification and data entry.

(5) Cash is deposited in the appropriate bank account based on funding restrictions.

D. Cash Disbursements

(1) Cash disbursements are made by check (with the exception of petty cash).

(2) The Executive Director approves all invoices for payment.

(3) Vendor invoices are recalculated on site to ensure accuracy. This recalculation must occur prior to the preparation of a check to pay the invoice. After the recalculation is complete, the employee who performed the recalculation must initial the vendor invoice, indicating that the amount is correct and the invoice can be paid.

(4) Checks for payment are signed only when supported by approved invoices (checks will not be processed and signed in advance of proper invoicing approval procedures).

(5) Check signers compare data on supporting documents to checks presented for their signature.

(6) Bank transfers are scheduled and investigated to ascertain that both sides of the transaction are recorded.
(7) The employee responsible for mailing checks will not be responsible for
recording cash disbursements. These two functions must be handled by
different employees to ensure that the appropriate checks and balances are in
place.

(8) Supporting documentation is noted as paid, check number, date paid, and
general ledger account code. Supporting documentation is noted as approved
for payment.

(9) Account codings for each payment are reviewed for accuracy.

(10) CDC finance and accounting staff will ensure that all costs paid through
the utilization of external funding sources are recognized as ordinary,
necessary, within the budget, are arms length transactions, and do not deviate
from established practices of the organization.

A cost will be considered reasonable if, in its nature or amount, it does not
exceed that which would be incurred by a prudent person under the
circumstances prevailing at the time the decision was made to incur the costs.

E. General Ledger Account Coding

(1) All cash receipts and disbursements are account coded and reviewed by the
Executive Director.

(2) A policy will be developed that documents the rationale used to allocate shared
expenses among functions, grants, and/or contracts and reviewed periodically.

(3) Funding from multiple sources may be kept in an account with other funding;
however, it must be tracked independently.

F. Revenue

(1) Revenue is earned using the accrual basis of accounting.

(2) Cost reimbursement grants or contracts earn revenue when the expenses are
incurred (not committed).

G. Expenses

(1) Expenses are charged directly to programs when specific identification is
available.

(2) Expenses are charged to programs based upon a shared cost rationale when
the direct charge cannot be established.

(3) Expenses are prohibited to be used for any purpose that is ineligible under a
funding award.

(4) Expenditures for each grant, loan, or contract are to be recorded according to
the budget categories for that particular funding source. For each funding
award, CDC will maintain records that allow for a comparison of outlays with approved budget amounts.

(5) When there are government funds involved, CDC will follow OMB A-122 cost principles.

(6) When there are government funds involved, programs and grants will not be charged for OMB A-122 unreimbursable items such as, but not limited to: entertainment, fundraising expenses, bad debts, fines or penalties or interest on debt.

(7) Before CDC seeks reimbursement from a funder, it will ensure that the costs for which it is seeking reimbursement are allocable to that funder. A cost will be considered allocable to an external funding source (unless otherwise prohibited) if it is treated consistently with other costs incurred for the same purpose in like circumstances and if:

a. The cost is incurred specifically for the award.

b. The cost benefits both the award and other work and can be distributed in reasonable proportion to the benefits received, or

c. Is necessary to the overall operation of the organization, although a direct relationship to any particular cost objective cannot be shown.

(8) Any cost allocable to a particular award or other cost objective may not be shifted to other awards to overcome funding deficiencies, or to avoid restrictions imposed by law or by the terms of any award of funds.

H. **Loan Loss Reserve (Only Applicable for CDCs that Make Loans)**

(1) Periodically, the members of the Executive Committee, the Executive Director, and members of the finance and accounting department will meet to review the adequacy of the organization’s loan loss reserve. Necessary adjustments will be determined and made quarterly.

I. **Collection of Delinquent Accounts**

(1) CDC may utilize outside collection agencies if all past efforts to collect money due have been exhausted.

(2) The Executive Director has discretionary authority to submit delinquent debts (over 90 days) to an outside collection agency.

J. **Write-off of Delinquent Debts/Charges**

(1) Records must indicate that all efforts to obtain payment have been exhausted before the decision is made to write off any debt.

(2) The request for approval of a write-off must include a short narrative of actions taken to collect and the rationale for the debt being considered uncollectable.
(3) The Executive Director of CDC has the discretion to approve debt write-offs of a board-authorized amount. Any amount above the board-authorized amount that is requested to be considered a write-off must be approved by the Executive Committee of the Board of Directors. Reference to this action will be included in the board packet for the next regularly scheduled Board of Directors Meeting.

(4) The budget line item for fees and collections must be updated by means of a budget revision to reflect uncollectable fees/debts.

(5) If collection is made of a debt previously written-off as uncollectable, it will be recognized as revenue in the current period.

II. Financial Reporting Procedures

A. The Chief Financial Officer will be responsible for compiling monthly and year-to-date reports on all cost centers by revenue source, expense code, and asset and liability account balances.

B. Financial reports are reconciled to the general ledger and accounting records prior to submission to the funding source.

C. If an expenditure is different from an external funding source’s approved budget, prior approval must be obtained from the funding source prior to the submission of the financial report.

D. Monthly financial reports which analyze CDC’s financial position and the effectiveness of its management and programs will be presented to the Executive Committee of the Board of Directors and also reported within the board packets.

E. Periodic reports will be provided to all funding sources as requested or required by contract.

F. CDC’s finance and accounting staff will maintain records that identify adequately the source and application of funds for all activities. These records shall contain information pertaining to awards, authorizations, obligations, assets, outlays, income and interest. Records to be maintained include copies of contracts, invoices, proof of payments and allocation tracking when costs are distributed among several funding sources.
III. Investment/Banking Policies

The CDC Board of Directors will approve the placement of assets not needed for immediate operations assuring compliance with all contractual requirements and using the principles identified below.

A. Principles:

(1) Minimize Risk: The Board will define a minimum risk strategy that will be reviewed annually to ensure appropriate discharge of responsibilities to donors, lenders, and contractual relationships.

(2) Maximize Investment Return: Within the parameters defined as “minimum risk”, funds will be invested at the highest area interest/return available at the time of decision.

(3) Support Local Banks and Institutions if Economically Feasible: “Local” is defined as having a physical presence for customer service within CDC’s service area.

B. Procedures:

(1) Each quarter, the Executive Director or his/her designee will review with the Executive Committee the projected cash needs of the corporation and the assets available for investment.

(2) Each quarter, the Executive Committee will provide the Executive Director or his/her designee with guidance regarding investment and institutions.

(3) The Executive Committee will designate a representative to consult with the Executive Director or his/her designee between meetings on such matters as investment period timeliness and institutional issues.

(4) The Executive Director or his/her designee will contact local institutions as needed to determine the best rate of return for investments.

(5) The Board of Directors will define a policy for minimizing risk annually.

C. Banking Policy

(1) CDC will keep all funds available not already invested in a federally insured bank.

(2) Support Local Banks if Economically Feasible: All assets kept in bank accounts will be in banks defined as local. “Local” is defined as having a physical presence for customer service within CDC’s service area.

IV. Budget Principles/Procedures

Structure of the budgetary process shall evolve from the mission and by-laws of CDC with consideration given to the requirements of any of the organization’s funding partners.
A. **Budget Principles**

(1) The budgetary process shall comply with the organization’s funding partners and in accordance with applicable state and federal laws.

(2) The budgetary process shall comply with the guidelines and principles set forth by the Board of Directors.

(3) Annually, each program area shall identify and develop a plan for its operation. The budgets needed to execute the plan shall be developed by appropriate personnel, with concurrence from the Executive Director.

B. **Procedures:**

(1) The organization’s Executive Director will prepare and submit an operating budget to the Board of Director’s 30-60 days prior to the beginning of the new fiscal year and prior to submission to funding sources.

(2) If budget submission is due to funding sources prior to 60 days before the beginning of the fiscal year, the organization’s Board of Directors will review a preliminary budget and adopt it if necessary.

(3) The approved preliminary or final operating budget will become the blueprint for the budget submission to all outside funders.

(4) Differences in budget line items between the organization’s operating budget and a funders’ approved budgets will be resolved in negotiations between the Executive Director and the funding agency.

C. **Adjustments in Budget/Spending Plans**

(1) Any adjustments or changes in spending policies/budget plans which vary by more than 10% from the original approved budget will be initialed by the Executive Director and submitted for approval to the Board of Directors.

(2) These changes will be communicated in writing to funding sources as required by contractual agreements.

(3) If proposed changes are unsatisfactory to the funder, the Executive Director will communicate this response to the Board of Directors, who may authorize:

   a. Changing the budget/plan to one which is satisfactory to the funder, or

   b. Entering into negotiations to develop a compromise satisfactory to the funder and the Board of Directors.

(4) After approval of the changes by all parties, the changes will be communicated in writing to all affected management staff.
V. Audit Procedures

A. CDC will contract for an independent audit to be performed by a Certified Public Accountant (CPA) at the conclusion of each fiscal year.

B. The auditor(s) will complete the audit within four months of the conclusion of the fiscal year.

C. The auditor(s) will test accounting mechanisms in accordance with generally accepted auditing standards for not-for-profit organizations and as contractually required by funding sources.

D. If during its established fiscal year, CDC expends over $300,000 in federal funding, it will contract for an audit that meets the requirements of OMB A-122 and A-133.

E. A formal written report of the audit will be presented to CDC’s Board of Directors and each principal funding source.
SECTION FOUR: Procurement Policies

The following policies and procedures will be followed at all times when CDC is using federal funds to purchase supplies, property, equipment and services from an external source:

I. General Contract Award Management Policy

1. No CDC officer, employee, and/or agent will participate in the selection, award, and/or administration of any contract for equipment, materials, and supplies or consulting or professional services if a real or apparent conflict of interest would be involved. Such a conflict will arise when:
   a. the employee, officer, or agent;
   b. any member of his/her immediate family;
   c. his/her partner; or
   d. an organization which employs or is about to employ, any of the above has a financial or other interest in the firm or individual selected for award.

2. CDC's officers, employees, and/or agents shall neither solicit nor accept gratuities, favors, or anything of monetary value from contractors, potential contractors, or parties to sub-agreements.

3. CDC will conduct a cost or price analysis and document such analysis in the procurement files in conjunction with every procurement action.

4. If a contract is competitively bid, CDC will enter into a contract with the winning bidder that specifies the services to be completed and payment terms.

5. At a minimum, to adequately evaluate contractor, consultant, and supplier performance, CDC will evaluate each respective provider of goods and services performance at the completion of each contract. This evaluation will be utilized when making award decisions for future contracts. Evaluations may be conducted on a more frequent basis if deemed necessary.

6. Procurement records and files will include the basis for contractor selection, justification for the lack of competition when competitive bids or offers are not obtained, and basis for award cost of price.
II. Acquisition Policy for Goods and Services

The following procurement procedure applies to all purchases of goods and services, including equipment, materials, supplies and professional and consulting services.

Employees will conduct all procurement transactions in a manner that maximizes free and open competition. Awards should be made to the bidder or offeror whose bid or offer is responsive to the solicitation and is most advantageous to the recipient, price, quality and other factors considered. CDC reserves the right to reject any and all bids or offers, if deemed to be in its best interest.

CDC may select from numerous methods of procurement, depending on the amount of the purchase and other considerations. Following are a few examples of possible procurement procedures that CDC may choose to use:

(1) Open Market Inquiry. The Executive Director, or other qualified individuals delegated by the Executive Director may inquire in the open market to ensure that the price and quality is the most advantageous to CDC.

(2) Request Competitive Oral Quotes. The Executive Director or his/her designee may request competitive quotes orally. A file shall be kept with an abstract of invitations made and offers received.

(3) Request Written Quotes from at Least three Different Sources. For purchases and contracts involving a single project or activity, the Executive Director or his/her designee may request and receive written quotations from at least three independent sources. A file shall be kept with an abstract of invitations made, offers received, and the criteria for selection.

(4) Request Written Competitive Responses through a Formal Request for Proposal Procedure. For large purchases and contracts, the Executive Director or his/her designee may solicit competitive responses through a formal written request for proposal procedure. Bids will remain sealed until the opening time designated in the request for proposals. All requests for proposals shall contain the phrase “Equal Opportunity Employer”.

For the largest purchases a CDC makes, after reviewing the bids received, the Executive Director or his/her designee shall make a recommendation to CDC’s Board of Directors regarding which bid to accept. A majority of the board must accept the bid via formal vote before a contract is executed for the service.

A file shall be kept with a copy of the request for proposal, a list of individuals/organizations solicited for bids, and a bid sheet that lists the bids received by individual/organization and their respective bid price. In all instances in which the lowest bid is not awarded the contract, justification documentation, such as a memo outlining the selection criteria, shall be placed in the file.
III. **Property/Equipment Standards**

When purchasing property (both real property and equipment), the following procedures will be followed:

1. Title to all property purchased with federal funds will vest with the CDC.
2. Property records will be kept showing the general name of the property, identification number, original cost, and depreciated value. These records will be reviewed and necessary revisions made on an annual basis at the end of CDC’s fiscal year.
3. CDC will provide the equivalent insurance coverage for real property and equipment regardless of how the property was acquired by the organization.
4. Equipment purchased, with a purchase price in excess of $5,000, with federal funds is generally considered the property of the federal government and must be disposed of through a set procedure. When disposing of equipment with an acquisition cost in excess of $5,000, CDC will follow the respective funding program’s disposal regulations.

IV. **Federal Debarment Standard**

A. When purchasing goods and services through the utilization of federal funding, CDC will ensure that the contract awardee is not debarred or suspended from doing business with the federal government nor delinquent in a debt to the United States as defined in OMB Circular A-129. Before a contract is awarded, staff from CDC will consult the Federal Government’s General Services Administration (“GSA”)’s "List of Parties Excluded from Federal Procurement or Non-procurement Programs".
SECTION FIVE: Records Management Policy

I. Records Management Policy

To ensure that all programs operated by CDC are properly managed and reported on, CDC will establish and monitor a comprehensive records management policy.

A. To ensure that pertinent records are properly managed, CDC will implement a file maintenance and disposition plan for each project/funding source when that project becomes inactive/closes-out. When a project is closed a file maintenance and disposition plan form will be filled out and filed for the project. The form includes, but is not limited to, the date the project began, the date the project ended, amount of contract, name and signature, a contact number for project’s manager, a description of the files within the storage case and their filing arrangement, and disposition instructions. Once the “File Maintenance and Disposition Plan” form has been completed, it will be filed and the storage box sent to CDC’s off-site storage facility.

B. Financial records, supporting documents, statistical records, and all other records pertinent to an award of funding from an external source shall be retained for a period of three years from the date of the submission of the final expenditure report. If any litigation, claim, or audit is started before the expiration of the three-year period, the records shall be retained until all litigation, claims, or audit findings have been resolved and final action taken.

C. Records for real property and equipment acquired with federal funds must be retained for three years after final disposition of said property.
## Business Record Retention Schedule

<table>
<thead>
<tr>
<th>ACCOUNTING AND FISCAL</th>
<th>Term</th>
<th>CORPORATE</th>
<th>Term</th>
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<tbody>
<tr>
<td>Accounts Payable Records</td>
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<td>Certificate of Incorporation</td>
<td>P</td>
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<tr>
<td>Accounts Receivable Records</td>
<td>3</td>
<td>Charter</td>
<td>P</td>
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<tr>
<td>Audit Reports</td>
<td>P</td>
<td>Annual Reports</td>
<td>P</td>
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<tr>
<td>Audit Reports Internal</td>
<td>3</td>
<td>Contracts (After Expiration)</td>
<td>3</td>
</tr>
<tr>
<td>Bank Statements and Reconciliation</td>
<td>3</td>
<td>Copyrights</td>
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</tr>
<tr>
<td>Canceled Checks</td>
<td>3</td>
<td>Correspondence (General)</td>
<td>3</td>
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<tr>
<td>Check Registers</td>
<td>3</td>
<td>Correspondence (Legal)</td>
<td>P</td>
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<tr>
<td>Cash Receipts Book</td>
<td>3</td>
<td>Insurance Policies (After Expiration)</td>
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<tr>
<td>Expense Analysis &amp; Distribution Schedules</td>
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<td>Inventories</td>
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<td>Financial Statements</td>
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<td>Leases (after expiration)</td>
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<tr>
<td>Fixed Assets Records</td>
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<td>Legal Briefs</td>
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<tr>
<td>General Ledgers</td>
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<td>Licenses</td>
<td>P</td>
</tr>
<tr>
<td>Invoices</td>
<td>3</td>
<td>Merger Acquisition Records</td>
<td>P</td>
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<tr>
<td>Journals/Cash Books</td>
<td>3</td>
<td>Board Minutes</td>
<td>P</td>
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<tr>
<td>Office Equipment Records (after disposition)</td>
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<tr>
<td>PERSONNEL</td>
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<tr>
<td>Employment History</td>
<td>P</td>
<td>Profit and Loss Statements</td>
<td>P</td>
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<tr>
<td>Individual Employee Records</td>
<td>P</td>
<td>Property Records</td>
<td>P</td>
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<tr>
<td>Payroll Register</td>
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<td>Trademark Records</td>
<td>P</td>
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<tr>
<td>Time Cards and Sheets</td>
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<td>Unclaimed Wages (given to state after 3 yrs)</td>
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<td>Canceled payroll checks</td>
<td>3</td>
<td>Annuity or Deferred Payment Plan</td>
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<td>Retirement and Pension Plans</td>
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<td>Payroll Tax Returns</td>
<td>3</td>
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<tr>
<td>Group Insurance Records</td>
<td>P</td>
<td>Withholding Tax Statements (W-2s)</td>
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</tr>
<tr>
<td>Training Materials</td>
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<td>Tax Bills and Statements</td>
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<tr>
<td>Employee Travel and Expense Reports</td>
<td>3</td>
<td>Federal Tax Returns &amp; Work Papers</td>
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</tr>
<tr>
<td>Interim Payroll Registers</td>
<td>3</td>
<td>State Tax Returns &amp; Work Papers</td>
<td>P</td>
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<td></td>
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<td>Sales and Misc. Tax Returns</td>
<td>3</td>
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<tr>
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<td>Depreciation Schedules</td>
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| TAXATION                               |      |                                        |      |
| Canceled payroll checks                | 3    |                                        |      |
| Retirement and Pension Plans           | P    |                                        |      |
| Group Insurance Records                | P    |                                        |      |
| Training Materials                     | 3    |                                        |      |
| Employee Travel and Expense Reports    | 3    |                                        |      |
| Interim Payroll Registers              | 3    |                                        |      |

P = Permanently
SECTION SIX: Drug-Free Work Place Policy

CDC is a drug-free work place and following is the organization's drug-free work place policy:

CDC does and will continue to provide a drug-free work place by:

A. Publicly posting a statement notifying employees that the unlawful manufacture, distribution, dispensing, possession, or use of a controlled substance is prohibited in the during normal working hours and on CDC properties.

B. CDC will operate an ongoing drug-free awareness program which informs employees about:
   (1) The dangers of drug abuse in the work place;
   (2) policy of maintaining a drug-free work place;
   (3) Any available drug counseling, rehabilitation, and employee assistance programs; and,
   (4) The penalties that may be imposed upon employees for drug abuse violations in the work place.

C. Providing each employee engaged in the performance of a grant be given a copy of the statement specified in paragraph A, above.

D. When an employee of CDC works on a government-funded project or activity that has funding with a drug-free work place certification, CDC will notify effected employees that they are required to:
   (1) Abide by the terms of the statement; and,
   (2) Notify the employer in writing of his/her conviction for a violation of a criminal drug statute occurring in the work place no later than five calendar days after such conviction.

E. CDC will notify the respective agency/funder grant officer(s) within 10 calendar days after receiving notice about a conviction from an employee or otherwise receiving actual notice of such conviction.

F. Within 30 days of being informed by an employee that he/she had been arrested on drug charges and convicted, CDC will:
   (1) Take appropriate personnel action against such employee, up to and including termination, consistent with the Rehabilitation Act of 1973, as amended; or,
   (2) Require the employee to participate and satisfactorily complete a drug abuse assistance or rehabilitation program approved for such purposes by a federal, state, or local health, law enforcement, or other appropriate agency.

G. CDC will strive to make a good faith effort to continue to maintain a drug-free work place through implementation of paragraphs A through F, above.
SECTION SEVEN: Acknowledgment Forms

I, __________________, acknowledge that I have read the **Policy Prohibiting Unlawful Harassment, Including Sexual Harassment**, which is contained in Article XI of Section Two of the CDC’s Policies and Procedures Manual, and I agree to the terms and provisions contained in such policy.

Name of Employee: _________________________________
Title: __________________________________________________________________
Date: __________________________________________________________________
Witness: __________________________________________________________________

I, __________________, acknowledge that I have read the **CDC’s Policies and Procedures Manual**, and I agree to comply with the terms and provisions contained in this manual.

Name of Employee: _________________________________
Title: __________________________________________________________________
Date: __________________________________________________________________
Witness: __________________________________________________________________
CIRCULAR A-110
(REVISED 11/19/93, As Further Amended 9/30/99)

CIRCULAR NO. A-110 Revised

TO THE HEADS OF EXECUTIVE DEPARTMENTS AND ESTABLISHMENTS

SUBJECT: Uniform Administrative Requirements for Grants and Agreements With Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations

1. Purpose. This Circular sets forth standards for obtaining consistency and uniformity among Federal agencies in the administration of grants to and agreements with institutions of higher education, hospitals, and other non-profit organizations.


3. Policy. Except as provided herein, the standards set forth in this Circular are applicable to all Federal agencies. If any statute specifically prescribes policies or specific requirements that differ from the standards provided herein, the provisions of the statute shall govern.

The provisions of the sections of this Circular shall be applied by Federal agencies to recipients. Recipients shall apply the provisions of this Circular to subrecipients performing substantive work under grants and agreements that are passed through or awarded by the primary recipient, if such subrecipients are organizations described in paragraph 1.

This Circular does not apply to grants, contracts, or other agreements between the Federal Government and units of State or local governments covered by OMB Circular A-102, "Grants and Cooperative agreements with State and Local Governments," and the Federal agencies' grants management common rule which standardized and codified the administrative requirements Federal agencies impose on State and local grantees. In addition, subawards and contracts to State or local governments are not covered by this Circular. However, this Circular applies to subawards made by State and local governments to organizations covered by this Circular. Federal agencies may apply the provisions of this Circular to commercial organizations, foreign governments, organizations under the jurisdiction of foreign governments, and international organizations.

4. Definitions. Definitions of key terms used in this Circular are contained in Section ___.2 in the Attachment.

5. Required Action. The specific requirements and responsibilities of Federal agencies and institutions of higher education, hospitals, and other non-profit organizations are set forth in this Circular. Federal agencies responsible for awarding and administering grants to and other agreements with organizations described in paragraph 1 shall adopt the language in the Circular unless different provisions are required by Federal statute or are approved by OMB.

6. OMB Responsibilities. OMB will review agency regulations and implementation of this Circular, and will provide interpretations of policy requirements and assistance to insure effective and efficient implementation. Any exceptions will be subject to approval by OMB, as indicated in Section ___.4 in the Attachment. Exceptions will only be made in particular cases where adequate justification is presented.

7. Information Contact. Further information concerning this Circular may be obtained by contacting the Office of Federal Financial Management, Office of Management and Budget, Washington, DC 20503, telephone (202) 395-3993.

8. Termination Review Date. This Circular will have a policy review three years from date of issuance.
9. **Effective Date.** The standards set forth in this Circular which affect Federal agencies will be effective 30 days after publication of the final revision in the Federal Register. Those standards which Federal agencies impose on grantees will be adopted by agencies in codified regulations within six months after publication in the Federal Register. Earlier implementation is encouraged.

Attachment

Grants and Agreements with Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations

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SUBPART A - General

Purpose. This Circular establishes uniform administrative requirements for Federal grants and agreements awarded to institutions of higher education, hospitals, and other non-profit organizations. Federal awarding agencies shall not impose additional or inconsistent requirements, except as provided in Sections .4, and .14 or unless specifically required by Federal statute or executive order. Non-profit organizations that implement Federal programs for the States are also subject to State requirements.

Definitions.
(a) Accrued expenditures means the charges incurred by the recipient during a given period requiring the provision of funds for: (1) goods and other tangible property received; (2) services performed by employees, contractors, subrecipients, and other payees; and, (3) other amounts becoming owed under programs for which no current services or performance is required.

(b) Accrued income means the sum of: (1) earnings during a given period from (i) services performed by the recipient, and (ii) goods and other tangible property delivered to purchasers, and (2) amounts becoming owed to the recipient for which no current services or performance is required by the recipient.

(c) Acquisition cost of equipment means the net invoice price of the equipment, including the cost of modifications, attachments, accessories, or auxiliary apparatus necessary to make the property usable for the purpose for which it was acquired. Other charges, such as the cost of installation, transportation, taxes, duty or protective in-transit insurance, shall be included or excluded from the unit acquisition cost in accordance with the recipient's regular accounting practices.

(d) Advance means a payment made by Treasury check or other appropriate payment mechanism to a recipient upon its request either before outlays are made by the recipient or through the use of predetermined payment schedules.

(e) Award means financial assistance that provides support or stimulation to accomplish a public purpose. Awards include grants and other agreements in the form of money or property in lieu of money, by the Federal Government to an eligible recipient. The term does not include: technical assistance, which provides services instead of money; other assistance in the form of loans, loan guarantees, interest subsidies, or insurance; direct payments of any kind to individuals; and, contracts which are required to be entered into and administered under procurement laws and regulations.
(f) Cash contributions means the recipient's cash outlay, including the outlay of money contributed to the recipient by third parties.

(g) Closeout means the process by which a Federal awarding agency determines that all applicable administrative actions and all required work of the award have been completed by the recipient and Federal awarding agency.

(h) Contract means a procurement contract under an award or subaward, and a procurement subcontract under a recipient's or subrecipient's contract.

(i) Cost sharing or matching means that portion of project or program costs not borne by the Federal Government.

(j) Date of completion means the date on which all work under an award is completed or the date on the award document, or any supplement or amendment thereto, on which Federal sponsorship ends.

(k) Disallowed costs means those charges to an award that the Federal awarding agency determines to be unallowable, in accordance with the applicable Federal cost principles or other terms and conditions contained in the award.

(l) Equipment means tangible nonexpendable personal property including exempt property charged directly to the award having a useful life of more than one year and an acquisition cost of $5000 or more per unit. However, consistent with recipient policy, lower limits may be established.

(m) Excess property means property under the control of any Federal awarding agency that, as determined by the head thereof, is no longer required for its needs or the discharge of its responsibilities.

(n) Exempt property means tangible personal property acquired in whole or in part with Federal funds, where the Federal awarding agency has statutory authority to vest title in the recipient without further obligation to the Federal Government. An example of exempt property authority is contained in the Federal Grant and Cooperative Agreement Act (31 U.S.C. 6306), for property acquired under an award to conduct basic or applied research by a non-profit institution of higher education or non-profit organization whose principal purpose is conducting scientific research.

(o) Federal awarding agency means the Federal agency that provides an award to the recipient.

(p) Federal funds authorized means the total amount of Federal funds obligated by the Federal Government for use by the recipient. This amount may include any authorized carryover of unobligated funds from prior funding periods when permitted by agency regulations or agency implementing instructions.

(q) Federal share of real property, equipment, or supplies means that percentage of the property's acquisition costs and any improvement expenditures paid with Federal funds.

(r) Funding period means the period of time when Federal funding is available for obligation by the recipient.

(s) Intangible property and debt instruments means, but is not limited to, trademarks, copyrights, patents and patent applications and such property as loans, notes and other debt instruments, lease agreements, stock and other instruments of property ownership, whether considered tangible or intangible.

(t) Obligations means the amounts of orders placed, contracts and grants awarded, services received and similar transactions during a given period that require payment by the recipient during the same or a future period.

(u) Outlays or expenditures means charges made to the project or program. They may be reported on a cash or accrual basis. For reports prepared on a cash basis, outlays are the sum of cash disbursements for direct charges for goods and services, the amount of indirect expense charged, the value of third party in-kind contributions applied and the amount of cash advances and payments made to subrecipients. For reports prepared on an accrual basis, outlays are the sum of cash disbursements for direct charges for goods and services, the amount of indirect expense incurred, the value of in-kind contributions applied, and the net increase (or decrease) in the amounts owed by the recipient for goods and other property received, for services performed by employees, contractors,
subrecipients and other payees and other amounts becoming owed under programs for which no current services or performance are required.

(v) Personal property means property of any kind except real property. It may be tangible, having physical existence, or intangible, having no physical existence, such as copyrights, patents, or securities.

(w) Prior approval means written approval by an authorized official evidencing prior consent.

(x) Program income means gross income earned by the recipient that is directly generated by a supported activity or earned as a result of the award (see exclusions in paragraphs ___24 (e) and (h)). Program income includes, but is not limited to, income from fees for services performed, the use or rental of real or personal property acquired under federally-funded projects, the sale of commodities or items fabricated under an award, license fees and royalties on patents and copyrights, and interest on loans made with award funds. Interest earned on advances of Federal funds is not program income. Except as otherwise provided in Federal awarding agency regulations or the terms and conditions of the award, program income does not include the receipt of principal on loans, rebates, credits, discounts, etc., or interest earned on any of them.

(y) Project costs means all allowable costs, as set forth in the applicable Federal cost principles, incurred by a recipient and the value of the contributions made by third parties in accomplishing the objectives of the award during the project period.

(z) Project period means the period established in the award document during which Federal sponsorship begins and ends.

(aa) Property means, unless otherwise stated, real property, equipment, intangible property and debt instruments.

(bb) Real property means land, including land improvements, structures and appurtenances thereto, but excludes movable machinery and equipment.

(cc) Recipient means an organization receiving financial assistance directly from Federal awarding agencies to carry out a project or program. The term includes public and private institutions of higher education, public and private hospitals, and other quasi-public and private non-profit organizations such as, but not limited to, community action agencies, research institutes, educational associations, and health centers. The term may include commercial organizations, foreign or international organizations (such as agencies of the United Nations) which are recipients, subrecipients, or contractors or subcontractors of recipients or subrecipients at the discretion of the Federal awarding agency. The term does not include government-owned contractor-operated facilities or research centers providing continued support for mission-oriented, large-scale programs that are government-owned or controlled, or are designated as federally-funded research and development centers.

(dd) Research and development means all research activities, both basic and applied, and all development activities that are supported at universities, colleges, and other non-profit institutions. "Research" is defined as a systematic study directed toward fuller scientific knowledge or understanding of the subject studied. "Development" is the systematic use of knowledge and understanding gained from research directed toward the production of useful materials, devices, systems, or methods, including design and development of prototypes and processes. The term research also includes activities involving the training of individuals in research techniques where such activities utilize the same facilities as other research and development activities and where such activities are not included in the instruction function.

(ee) Small awards means a grant or cooperative agreement not exceeding the small purchase threshold fixed at 41 U.S.C. 403(11) (currently $25,000).

(ff) Subaward means an award of financial assistance in the form of money, or property in lieu of money, made under an award by a recipient to an eligible subrecipient or by a subrecipient to a lower tier subrecipient. The term includes financial assistance when provided by any legal agreement, even if the agreement is called a contract, but does not include procurement of goods and services nor does it include any form of assistance which is excluded from the definition of "award" in paragraph (e).
(gg) Subrecipient means the legal entity to which a subaward is made and which is accountable to the recipient for the use of the funds provided. The term may include foreign or international organizations (such as agencies of the United Nations) at the discretion of the Federal awarding agency.

(hh) Supplies means all personal property excluding equipment, intangible property, and debt instruments as defined in this section, and inventions of a contractor conceived or first actually reduced to practice in the performance of work under a funding agreement ("subject inventions"), as defined in 37 CFR part 401, "Rights to Inventions Made by Nonprofit Organizations and Small Business Firms Under Government Grants, Contracts, and Cooperative Agreements."

(ii) Suspension means an action by a Federal awarding agency that temporarily withdraws Federal sponsorship under an award, pending corrective action by the recipient or pending a decision to terminate the award by the Federal awarding agency. Suspension of an award is a separate action from suspension under Federal agency regulations implementing E.O.s 12549 and 12689, "Debarment and Suspension."

(jj) Termination means the cancellation of Federal sponsorship, in whole or in part, under an agreement at any time prior to the date of completion.

(kk) Third party in-kind contributions means the value of non-cash contributions provided by non-Federal third parties. Third party in-kind contributions may be in the form of real property, equipment, supplies and other expendable property, and the value of goods and services directly benefiting and specifically identifiable to the project or program.

(ll) Unliquidated obligations, for financial reports prepared on a cash basis, means the amount of obligations incurred by the recipient that have not been paid. For reports prepared on an accrued expenditure basis, they represent the amount of obligations incurred by the recipient for which an outlay has not been recorded.

(mm) Unobligated balance means the portion of the funds authorized by the Federal awarding agency that has not been obligated by the recipient and is determined by deducting the cumulative obligations from the cumulative funds authorized.

(nn) Unrecovered indirect cost means the difference between the amount awarded and the amount which could have been awarded under the recipient's approved negotiated indirect cost rate.

(oo) Working capital advance means a procedure where by funds are advanced to the recipient to cover its estimated disbursement needs for a given initial period.

___.3 Effect on other issuances. For awards subject to this Circular, all administrative requirements of codified program regulations, program manuals, handbooks and other nonregulatory materials which are inconsistent with the requirements of this Circular shall be superseded, except to the extent they are required by statute, or authorized in accordance with the deviations provision in Section ___.4.

___.4 Deviations. The Office of Management and Budget (OMB) may grant exceptions for classes of grants or recipients subject to the requirements of this Circular when exceptions are not prohibited by statute. However, in the interest of maximum uniformity, exceptions from the requirements of this Circular shall be permitted only in unusual circumstances. Federal awarding agencies may apply more restrictive requirements to a class of recipients when approved by OMB. Federal awarding agencies may apply less restrictive requirements when awarding small awards, except for those requirements which are statutory. Exceptions on a case-by-case basis may also be made by Federal awarding agencies.

___.5 Subawards. Unless sections of this Circular specifically exclude subrecipients from coverage, the provisions of this Circular shall be applied to subrecipients performing work under awards if such subrecipients are institutions of higher education, hospitals or other non-profit organizations. State and local government subrecipients are subject to the provisions of regulations implementing the grants management common rule, "Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments," published at 53 FR 8034 (3/11/88).
SUBPART B - Pre-Award Requirements

_.10 Purpose. Sections _.11 through _.17 prescribes forms and instructions and other pre-award matters to be used in applying for Federal awards.

_.11 Pre-award policies.

(a) Use of Grants and Cooperative Agreements, and Contracts. In each instance, the Federal awarding agency shall decide on the appropriate award instrument (i.e., grant, cooperative agreement, or contract). The Federal Grant and Cooperative Agreement Act (31 U.S.C. 6301-08) governs the use of grants, cooperative agreements and contracts. A grant or cooperative agreement shall be used only when the principal purpose of a transaction is to accomplish a public purpose of support or stimulation authorized by Federal statute. The statutory criterion for choosing between grants and cooperative agreements is that for the latter, "substantial involvement is expected between the executive agency and the State, local government, or other recipient when carrying out the activity contemplated in the agreement." Contracts shall be used when the principal purpose is acquisition of property or services for the direct benefit or use of the Federal Government.

(b) Public Notice and Priority Setting. Federal awarding agencies shall notify the public of its intended funding priorities for discretionary grant programs, unless funding priorities are established by Federal statute.

_.12 Forms for applying for Federal assistance.

(a) Federal awarding agencies shall comply with the applicable report clearance requirements of 5 CFR part 1320, "Controlling Paperwork Burdens on the Public," with regard to all forms used by the Federal awarding agency in place of or as a supplement to the Standard Form 424 (SF-424) series.

(b) Applicants shall use the SF-424 series or those forms and instructions prescribed by the Federal awarding agency.

(c) For Federal programs covered by E.O. 12372, "Intergovernmental Review of Federal Programs," the applicant shall complete the appropriate sections of the SF-424 (Application for Federal Assistance) indicating whether the application was subject to review by the State Single Point of Contact (SPOC). The name and address of the SPOC for a particular State can be obtained from the Federal awarding agency or the Catalog of Federal Domestic Assistance. The SPOC shall advise the applicant whether the program for which application is made has been selected by that State for review.

(d) Federal awarding agencies that do not use the SF-424 form should indicate whether the application is subject to review by the State under E.O. 12372.

_.13 Debarment and suspension. Federal awarding agencies and recipients shall comply with the nonprocurement debarment and suspension common rule implementing E.O.s 12549 and 12689, "Debarment and Suspension." This common rule restricts subawards and contracts with certain parties that are debarred, suspended or otherwise excluded from or ineligible for participation in Federal assistance programs or activities.

_.14 Special award conditions. If an applicant or recipient: (a) has a history of poor performance, (b) is not financially stable, (c) has a management system that does not meet the standards prescribed in this Circular, (d) has not conformed to the terms and conditions of a previous award, or (e) is not otherwise responsible, Federal awarding agencies may impose additional requirements as needed, provided that such applicant or recipient is notified in writing as to: the nature of the additional requirements, the reason why the additional requirements are being imposed, the nature of the corrective action needed, the time allowed for completing the corrective actions, and the method for requesting reconsideration of the additional requirements imposed. Any special conditions shall be promptly removed once the conditions that prompted them have been corrected.

_.15 Metric system of measurement. The Metric Conversion Act, as amended by the Omnibus Trade and Competitiveness Act (15 U.S.C. 205) declares that the metric system is the preferred measurement system for U.S. trade and commerce. The Act requires each Federal agency to establish a date or dates in consultation with the Secretary of Commerce, when the metric system of measurement will be used in the agency's procurements, grants, and other business-related activities. Metric implementation may take longer where the use of the system is initially impractical or likely to cause significant inefficiencies in the accomplishment of federally-funded activities.
Federal awarding agencies shall follow the provisions of E.O. 12770, "Metric Usage in Federal Government Programs."

Under the Act, any State agency or agency of a political subdivision of a State which is using appropriated Federal funds must comply with Section 6002. Section 6002 requires that preference be given in procurement programs to the purchase of specific products containing recycled materials identified in guidelines developed by the Environmental Protection Agency (EPA) (40 CFR parts 247-254). Accordingly, State and local institutions of higher education, hospitals, and non-profit organizations that receive direct Federal awards or other Federal funds shall give preference in their procurement programs funded with Federal funds to the purchase of recycled products pursuant to the EPA guidelines.

_.17 Certifications and representations. Unless prohibited by statute or codified regulation, each Federal awarding agency is authorized and encouraged to allow recipients to submit certifications and representations required by statute, executive order, or regulation on an annual basis, if the recipients have ongoing and continuing relationships with the agency. Annual certifications and representations shall be signed by responsible officials with the authority to ensure recipients' compliance with the pertinent requirements.

SUBPART C - Post-Award Requirements

Financial and Program Management


_.21 Standards for financial management systems.
(a) Federal awarding agencies shall require recipients to relate financial data to performance data and develop unit cost information whenever practical.
(b) Recipients' financial management systems shall provide for the following.
(1) Accurate, current and complete disclosure of the financial results of each federally-sponsored project or program in accordance with the reporting requirements set forth in Section _.52. If a Federal awarding agency requires reporting on an accrual basis from a recipient that maintains its records on other than an accrual basis, the recipient shall not be required to establish an accrual accounting system. These recipients may develop such accrual data for its reports on the basis of an analysis of the documentation on hand.
(2) Records that identify adequately the source and application of funds for federally-sponsored activities. These records shall contain information pertaining to Federal awards, authorizations, obligations, unobligated balances, assets, outlays, income and interest.
(3) Effective control over and accountability for all funds, property and other assets. Recipients shall adequately safeguard all such assets and assure they are used solely for authorized purposes.
(4) Comparison of outlays with budget amounts for each award. Whenever appropriate, financial information should be related to performance and unit cost data.
(5) Written procedures to minimize the time elapsing between the transfer of funds to the recipient from the U.S. Treasury and the issuance or redemption of checks, warrants or payments by other means for program purposes by the recipient. To the extent that the provisions of the Cash Management Improvement Act (CMIA) (Pub. L. 101-453) govern, payment methods of State agencies, instrumentalities, and fiscal agents shall be consistent with CMIA Treasury-State Agreements or the CMIA default procedures codified at 31 CFR part 205, "Withdrawal of Cash from the Treasury for Advances under Federal Grant and Other Programs."
(6) Written procedures for determining the reasonableness, allocability and allowability of costs in accordance with the provisions of the applicable Federal cost principles and the terms and conditions of the award.

(7) Accounting records including cost accounting records that are supported by source documentation.

(c) Where the Federal Government guarantees or insures the repayment of money borrowed by the recipient, the Federal awarding agency, at its discretion, may require adequate bonding and insurance if the bonding and insurance requirements of the recipient are not deemed adequate to protect the interest of the Federal Government.

(d) The Federal awarding agency may require adequate fidelity bond coverage where the recipient lacks sufficient coverage to protect the Federal Government's interest.

(e) Where bonds are required in the situations described above, the bonds shall be obtained from companies holding certificates of authority as acceptable sureties, as prescribed in 31 CFR part 223, "Surety Companies Doing Business with the United States."

___ 22 Payment.

(a) Payment methods shall minimize the time elapsing between the transfer of funds from the United States Treasury and the issuance or redemption of checks, warrants, or payment by other means by the recipients. Payment methods of State agencies or instrumentalities shall be consistent with Treasury-State CMIA agreements or default procedures codified at 31 CFR part 205.

(b) Recipients are to be paid in advance, provided they maintain or demonstrate the willingness to maintain: (1) written procedures that minimize the time elapsing between the transfer of funds and disbursement by the recipient, and (2) financial management systems that meet the standards for fund control and accountability as established in Section ___ 21. Cash advances to a recipient organization shall be limited to the minimum amounts needed and be timed to be in accordance with the actual, immediate cash requirements of the recipient organization in carrying out the purpose of the approved program or project. The timing and amount of cash advances shall be as close as is administratively feasible to the actual disbursements by the recipient organization for direct program or project costs and the proportionate share of any allowable indirect costs.

(c) Whenever possible, advances shall be consolidated to cover anticipated cash needs for all awards made by the Federal awarding agency to the recipient.

(1) Advance payment mechanisms include, but are not limited to, Treasury check and electronic funds transfer.

(2) Advance payment mechanisms are subject to 31 CFR part 205.

(3) Recipients shall be authorized to submit requests for advances and reimbursements at least monthly when electronic fund transfers are not used.

(d) Requests for Treasury check advance payment shall be submitted on SF-270, "Request for Advance or Reimbursement," or other forms as may be authorized by OMB. This form is not to be used when Treasury check advance payments are made to the recipient automatically through the use of a predetermined payment schedule or if precluded by special Federal awarding agency instructions for electronic funds transfer.

(e) Reimbursement is the preferred method when the requirements in paragraph (b) cannot be met. Federal awarding agencies may also use this method on any construction agreement, or if the major portion of the construction project is accomplished through private market financing or Federal loans, and the Federal assistance constitutes a minor portion of the project.

(1) When the reimbursement method is used, the Federal awarding agency shall make payment within 30 days after receipt of the billing, unless the billing is improper.

(2) Recipients shall be authorized to submit request for reimbursement at least monthly when electronic funds transfers are not used.
(f) If a recipient cannot meet the criteria for advance payments and the Federal awarding agency has determined that reimbursement is not feasible because the recipient lacks sufficient working capital, the Federal awarding agency may provide cash on a working capital advance basis. Under this procedure, the Federal awarding agency shall advance cash to the recipient to cover its estimated disbursement needs for an initial period generally geared to the awardee's disbursement cycle. Thereafter, the Federal awarding agency shall reimburse the recipient for its actual cash disbursements. The working capital advance method of payment shall not be used for recipients unwilling or unable to provide timely advances to their subrecipient to meet the subrecipient's actual cash disbursements.

(g) To the extent available, recipients shall disburse funds available from repayments to and interest earned on a revolving fund, program income, rebates, refunds, contract settlements, audit recoveries and interest earned on such funds before requesting additional cash payments.

(h) Unless otherwise required by statute, Federal awarding agencies shall not withhold payments for proper charges made by recipients at any time during the project period unless (1) or (2) apply.

(1) A recipient has failed to comply with the project objectives, the terms and conditions of the award, or Federal reporting requirements.

(2) The recipient or subrecipient is delinquent in a debt to the United States as defined in OMB Circular A-129, "Managing Federal Credit Programs." Under such conditions, the Federal awarding agency may, upon reasonable notice, inform the recipient that payments shall not be made for obligations incurred after a specified date until the conditions are corrected or the indebtedness to the Federal Government is liquidated.

(i) Standards governing the use of banks and other institutions as depositories of funds advanced under awards are as follows.

(1) Except for situations described in paragraph (i)(2), Federal awarding agencies shall not require separate depository accounts for funds provided to a recipient or establish any eligibility requirements for depositories for funds provided to a recipient. However, recipients must be able to account for the receipt, obligation and expenditure of funds.

(2) Advances of Federal funds shall be deposited and maintained in insured accounts whenever possible.

(j) Consistent with the national goal of expanding the opportunities for women-owned and minority-owned business enterprises, recipients shall be encouraged to use women-owned and minority-owned banks (a bank which is owned at least 50 percent by women or minority group members).

(k) Recipients shall maintain advances of Federal funds in interest bearing accounts, unless (1), (2) or (3) apply.

(1) The recipient receives less than $120,000 in Federal awards per year.

(2) The best reasonably available interest bearing account would not be expected to earn interest in excess of $250 per year on Federal cash balances.

(3) The depository would require an average or minimum balance so high that it would not be feasible within the expected Federal and non-Federal cash resources.

(l) For those entities where CMIA and its implementing regulations do not apply, interest earned on Federal advances deposited in interest bearing accounts shall be remitted annually to Department of Health and Human Services, Payment Management System, Rockville, MD 20852. Interest amounts up to $250 per year may be retained by the recipient for administrative expense. State universities and hospitals shall comply with CMIA, as it pertains to interest. If an entity subject to CMIA uses its own funds to pay pre-award costs for discretionary awards without prior written approval from the Federal awarding agency, it waives its right to recover the interest under CMIA.

(m) Except as noted elsewhere in this Circular, only the following forms shall be authorized for the recipients in requesting advances and reimbursements. Federal agencies shall not require more than an original and two copies of these forms.
(1) SF-270, Request for Advance or Reimbursement. Each Federal awarding agency shall adopt the SF-270 as a standard form for all nonconstruction programs when electronic funds transfer or predetermined advance methods are not used. Federal awarding agencies, however, have the option of using this form for construction programs in lieu of the SF-271, "Outlay Report and Request for Reimbursement for Construction Programs."

(2) SF-271, Outlay Report and Request for Reimbursement for Construction Programs. Each Federal awarding agency shall adopt the SF-271 as the standard form to be used for requesting reimbursement for construction programs. However, a Federal awarding agency may substitute the SF-270 when the Federal awarding agency determines that it provides adequate information to meet Federal needs.

---.23 Cost sharing or matching.

(a) All contributions, including cash and third party in-kind, shall be accepted as part of the recipient's cost sharing or matching when such contributions meet all of the following criteria.

(1) Are verifiable from the recipient's records.

(2) Are not included as contributions for any other federally-assisted project or program.

(3) Are necessary and reasonable for proper and efficient accomplishment of project or program objectives.

(4) Are allowable under the applicable cost principles.

(5) Are not paid by the Federal Government under another award, except where authorized by Federal statute to be used for cost sharing or matching.

(6) Are provided for in the approved budget when required by the Federal awarding agency.

(7) Conform to other provisions of this Circular, as applicable.

(b) Unrecovered indirect costs may be included as part of cost sharing or matching only with the prior approval of the Federal awarding agency.

(c) Values for recipient contributions of services and property shall be established in accordance with the applicable cost principles. If a Federal awarding agency authorizes recipients to donate buildings or land for construction/facilities acquisition projects or long-term use, the value of the donated property for cost sharing or matching shall be the lesser of (1) or (2).

(1) The certified value of the remaining life of the property recorded in the recipient's accounting records at the time of donation.

(2) The current fair market value. However, when there is sufficient justification, the Federal awarding agency may approve the use of the current fair market value of the donated property, even if it exceeds the certified value at the time of donation to the project.

(d) Volunteer services furnished by professional and technical personnel, consultants, and other skilled and unskilled labor may be counted as cost sharing or matching if the service is an integral and necessary part of an approved project or program. Rates for volunteer services shall be consistent with those paid for similar work in the recipient's organization. In those instances in which the required skills are not found in the recipient organization, rates shall be consistent with those paid for similar work in the labor market in which the recipient competes for the kind of services involved. In either case, paid fringe benefits that are reasonable, allowable, and allocable may be included in the valuation.

(e) When an employer other than the recipient furnishes the services of an employee, these services shall be valued at the employee's regular rate of pay (plus an amount of fringe benefits that are reasonable, allowable, and allocable, but exclusive of overhead costs), provided these services are in the same skill for which the employee is normally paid.
(f) Donated supplies may include such items as expendable equipment, office supplies, laboratory supplies or workshop and classroom supplies. Value assessed to donated supplies included in the cost sharing or matching share shall be reasonable and shall not exceed the fair market value of the property at the time of the donation.

(g) The method used for determining cost sharing or matching for donated equipment, buildings and land for which title passes to the recipient may differ according to the purpose of the award, if (1) or (2) apply.

(1) If the purpose of the award is to assist the recipient in the acquisition of equipment, buildings or land, the total value of the donated property may be claimed as cost sharing or matching.

(2) If the purpose of the award is to support activities that require the use of equipment, buildings or land, normally only depreciation or use charges for equipment and buildings may be made. However, the full value of equipment or other capital assets and fair rental charges for land may be allowed, provided that the Federal awarding agency has approved the charges.

(h) The value of donated property shall be determined in accordance with the usual accounting policies of the recipient, with the following qualifications.

(1) The value of donated land and buildings shall not exceed its fair market value at the time of donation to the recipient as established by an independent appraiser (e.g., certified real property appraiser or General Services Administration representative) and certified by a responsible official of the recipient.

(2) The value of donated equipment shall not exceed the fair market value of equipment of the same age and condition at the time of donation.

(3) The value of donated space shall not exceed the fair rental value of comparable space as established by an independent appraisal of comparable space and facilities in a privately-owned building in the same locality.

(4) The value of loaned equipment shall not exceed its fair rental value.

(5) The following requirements pertain to the recipient’s supporting records for in-kind contributions from third parties.

(i) Volunteer services shall be documented and, to the extent feasible, supported by the same methods used by the recipient for its own employees.

(ii) The basis for determining the valuation for personal service, material, equipment, buildings and land shall be documented.

__.24 Program income.

(a) Federal awarding agencies shall apply the standards set forth in this section in requiring recipient organizations to account for program income related to projects financed in whole or in part with Federal funds.

(b) Except as provided in paragraph (h) below, program income earned during the project period shall be retained by the recipient and, in accordance with Federal awarding agency regulations or the terms and conditions of the award, shall be used in one or more of the ways listed in the following.

(1) Added to funds committed to the project by the Federal awarding agency and recipient and used to further eligible project or program objectives.

(2) Used to finance the non-Federal share of the project or program.

(3) Deducted from the total project or program allowable cost in determining the net allowable costs on which the Federal share of costs is based.

(c) When an agency authorizes the disposition of program income as described in paragraphs (b)(1) or (b)(2), program income in excess of any limits stipulated shall be used in accordance with paragraph (b)(3).
(d) In the event that the Federal awarding agency does not specify in its regulations or the terms and conditions of the award how program income is to be used, paragraph (b)(3) shall apply automatically to all projects or programs except research. For awards that support research, paragraph (b)(1) shall apply automatically unless the awarding agency indicates in the terms and conditions another alternative on the award or the recipient is subject to special award conditions, as indicated in Section ___.14.

(e) Unless Federal awarding agency regulations or the terms and conditions of the award provide otherwise, recipients shall have no obligation to the Federal Government regarding program income earned after the end of the project period.

(f) If authorized by Federal awarding agency regulations or the terms and conditions of the award, costs incident to the generation of program income may be deducted from gross income to determine program income, provided these costs have not been charged to the award.

(g) Proceeds from the sale of property shall be handled in accordance with the requirements of the Property Standards (See Sections ___.30 through ___.37).

(h) Unless Federal awarding agency regulations or the terms and condition of the award provide otherwise, recipients shall have no obligation to the Federal Government with respect to program income earned from license fees and royalties for copyrighted material, patents, patent applications, trademarks, and inventions produced under an award. However, Patent and Trademark Amendments (35 U.S.C. 18) apply to inventions made under an experimental, developmental, or research award.

___ .25 Revision of budget and program plans.

(a) The budget plan is the financial expression of the project or program as approved during the award process. It may include either the Federal and non-Federal share, or only the Federal share, depending upon Federal awarding agency requirements. It shall be related to performance for program evaluation purposes whenever appropriate.

(b) Recipients are required to report deviations from budget and program plans, and request prior approvals for budget and program plan revisions, in accordance with this section.

(c) For nonconstruction awards, recipients shall request prior approvals from Federal awarding agencies for one or more of the following program or budget related reasons.

(1) Change in the scope or the objective of the project or program (even if there is no associated budget revision requiring prior written approval).

(2) Change in a key person specified in the application or award document.

(3) The absence for more than three months, or a 25 percent reduction in time devoted to the project, by the approved project director or principal investigator.

(4) The need for additional Federal funding.

(5) The transfer of amounts budgeted for indirect costs to absorb increases in direct costs, or vice versa, if approval is required by the Federal awarding agency.


(7) The transfer of funds allotted for training allowances (direct payment to trainees) to other categories of expense.
(8) Unless described in the application and funded in the approved awards, the subaward, transfer or contracting out of any work under an award. This provision does not apply to the purchase of supplies, material, equipment or general support services.

(d) No other prior approval requirements for specific items may be imposed unless a deviation has been approved by OMB.

(e) Except for requirements listed in paragraphs (c)(1) and (c)(4) of this section, Federal awarding agencies are authorized, at their option, to waive cost-related and administrative prior written approvals required by this Circular and OMB Circulars A-21 and A-122. Such waivers may include authorizing recipients to do any one or more of the following.

(1) Incur pre-award costs 90 calendar days prior to award or more than 90 calendar days with the prior approval of the Federal awarding agency. All pre-award costs are incurred at the recipient’s risk (i.e., the Federal awarding agency is under no obligation to reimburse such costs if for any reason the recipient does not receive an award or if the award is less than anticipated and inadequate to cover such costs).

(2) Initiate a one-time extension of the expiration date of the award of up to 12 months unless one or more of the following conditions apply. For one-time extensions, the recipient must notify the Federal awarding agency in writing with the supporting reasons and revised expiration date at least 10 days before the expiration date specified in the award. This one-time extension may not be exercised merely for the purpose of using unobligated balances.

   (i) The terms and conditions of award prohibit the extension.
   (ii) The extension requires additional Federal funds.
   (iii) The extension involves any change in the approved objectives or scope of the project.

(3) Carry forward unobligated balances to subsequent funding periods.

(4) For awards that support research, unless the Federal awarding agency provides otherwise in the award or in the agency’s regulations, the prior approval requirements described in paragraph (e) are automatically waived (i.e., recipients need not obtain such prior approvals) unless one of the conditions included in paragraph (e)(2) applies.

   (f) The Federal awarding agency may, at its option, restrict the transfer of funds among direct cost categories or programs, functions and activities for awards in which the Federal share of the project exceeds $100,000 and the cumulative amount of such transfers exceeds or is expected to exceed 10 percent of the total budget as last approved by the Federal awarding agency. No Federal awarding agency shall permit a transfer that would cause any Federal appropriation or part thereof to be used for purposes other than those consistent with the original intent of the appropriation.

(g) All other changes to nonconstruction budgets, except for the changes described in paragraph (j), do not require prior approval.

(h) For construction awards, recipients shall request prior written approval promptly from Federal awarding agencies for budget revisions whenever (1), (2) or (3) apply.

   (1) The revision results from changes in the scope or the objective of the project or program.
   (2) The need arises for additional Federal funds to complete the project.
   (3) A revision is desired which involves specific costs for which prior written approval requirements may be imposed consistent with applicable OMB cost principles listed in Section _____.27.

   (i) No other prior approval requirements for specific items may be imposed unless a deviation has been approved by OMB.
(j) When a Federal awarding agency makes an award that provides support for both construction and nonconstruction work, the Federal awarding agency may require the recipient to request prior approval from the Federal awarding agency before making any fund or budget transfers between the two types of work supported.

(k) For both construction and nonconstruction awards, Federal awarding agencies shall require recipients to notify the Federal awarding agency in writing promptly whenever the amount of Federal authorized funds is expected to exceed the needs of the recipient for the project period by more than $5000 or five percent of the Federal award, whichever is greater. This notification shall not be required if an application for additional funding is submitted for a continuation award.

(l) When requesting approval for budget revisions, recipients shall use the budget forms that were used in the application unless the Federal awarding agency indicates a letter of request suffices.

(m) Within 30 calendar days from the date of receipt of the request for budget revisions, Federal awarding agencies shall review the request and notify the recipient whether the budget revisions have been approved. If the revision is still under consideration at the end of 30 calendar days, the Federal awarding agency shall inform the recipient in writing of the date when the recipient may expect the decision.

___26 Non-Federal audits.

(a) Recipients and subrecipients that are institutions of higher education or other non-profit organizations (including hospitals) shall be subject to the audit requirements contained in the Single Audit Act Amendments of 1996 (31 USC 7501-7507) and revised OMB Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations."

(b) State and local governments shall be subject to the audit requirements contained in the Single Audit Act Amendments of 1996 (31 USC 7501-7507) and revised OMB Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations."

(c) For-profit hospitals not covered by the audit provisions of revised OMB Circular A-133 shall be subject to the audit requirements of the Federal awarding agencies.

(d) Commercial organizations shall be subject to the audit requirements of the Federal awarding agency or the prime recipient as incorporated into the award document.

___27 Allowable costs. For each kind of recipient, there is a set of Federal principles for determining allowable costs. Allowability of costs shall be determined in accordance with the cost principles applicable to the entity incurring the costs. Thus, allowability of costs incurred by State, local or federally-recognized Indian tribal governments is determined in accordance with the provisions of OMB Circular A-87, "Cost Principles for State, Local, and Indian Tribal Governments." The allowability of costs incurred by non-profit organizations is determined in accordance with the provisions of OMB Circular A-122, "Cost Principles for Non-Profit Organizations." The allowability of costs incurred by institutions of higher education is determined in accordance with the provisions of OMB Circular A-21, "Cost Principles for Educational Institutions." The allowability of costs incurred by hospitals is determined in accordance with the provisions of Appendix E of 45 CFR part 74, "Principles for Determining Costs Applicable to Research and Development Under Grants and Contracts with Hospitals." The allowability of costs incurred by commercial organizations and those non-profit organizations listed in Attachment C to Circular A-122 is determined in accordance with the provisions of the Federal Acquisition Regulation (FAR) at 48 CFR part 31.

___28 Period of availability of funds. Where a funding period is specified, a recipient may charge to the grant only allowable costs resulting from obligations incurred during the funding period and any pre-award costs authorized by the Federal awarding agency.

___29 Conditional exemptions.

(a) OMB authorizes conditional exemption from OMB administrative requirements and cost principles circulars for certain Federal programs with statutorily-authorized consolidated planning and consolidated administrative funding, that are identified by a Federal agency and approved by the head of the Executive department or establishment. A Federal agency shall consult with OMB during its consideration of whether to grant such an exemption.
(b) To promote efficiency in State and local program administration, when Federal non-entitlement programs with common purposes have specific statutorily-authorized consolidated planning and consolidated administrative funding and where most of the State agency's resources come from non-Federal sources, Federal agencies may exempt these covered State-administered, non-entitlement grant programs from certain OMB grants management requirements. The exemptions would be from all but the allocability of costs provisions of OMB Circulars A-87 (Attachment A, subsection C.3), "Cost Principles for State, Local, and Indian Tribal Governments," A-21 (Section C, subpart 4), "Cost Principles for Educational Institutions," and A-122 (Attachment A, subsection A.4), "Cost Principles for Non-Profit Organizations," and from all of the administrative requirements provisions of OMB Circular A-110, "Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations," and the agencies' grants management common rule.

(c) When a Federal agency provides this flexibility, as a prerequisite to a State's exercising this option, a State must adopt its own written fiscal and administrative requirements for expending and accounting for all funds, which are consistent with the provisions of OMB Circular A-87, and extend such policies to all subrecipients. These fiscal and administrative requirements must be sufficiently specific to ensure that: funds are used in compliance with all applicable Federal statutory and regulatory provisions, costs are reasonable and necessary for operating these programs, and funds are not be used for general expenses required to carry out other responsibilities of a State or its subrecipients.

**Property Standards**

---.30 Purpose of property standards. Sections --.31 through --.37 set forth uniform standards governing management and disposition of property furnished by the Federal Government whose cost was charged to a project supported by a Federal award. Federal awarding agencies shall require recipients to observe these standards under awards and shall not impose additional requirements, unless specifically required by Federal statute. The recipient may use its own property management standards and procedures provided it observes the provisions of Sections --.31 through --.37.

---.31 Insurance coverage. Recipients shall, at a minimum, provide the equivalent insurance coverage for real property and equipment acquired with Federal funds as provided to property owned by the recipient. Federally-owned property need not be insured unless required by the terms and conditions of the award.

---.32 Real property. Each Federal awarding agency shall prescribe requirements for recipients concerning the use and disposition of real property acquired in whole or in part under awards. Unless otherwise provided by statute, such requirements, at a minimum, shall contain the following.

(a) Title to real property shall vest in the recipient subject to the condition that the recipient shall use the real property for the authorized purpose of the project as long as it is needed and shall not encumber the property without approval of the Federal awarding agency.

(b) The recipient shall obtain written approval by the Federal awarding agency for the use of real property in other federally-sponsored projects when the recipient determines that the property is no longer needed for the purpose of the original project. Use in other projects shall be limited to those under federally-sponsored projects (i.e., awards) or programs that have purposes consistent with those authorized for support by the Federal awarding agency.

(c) When the real property is no longer needed as provided in paragraphs (a) and (b), the recipient shall request disposition instructions from the Federal awarding agency or its successor Federal awarding agency. The Federal awarding agency shall observe one or more of the following disposition instructions.

(1) The recipient may be permitted to retain title without further obligation to the Federal Government after it compensates the Federal Government for that percentage of the current fair market value of the property attributable to the Federal participation in the project.

(2) The recipient may be directed to sell the property under guidelines provided by the Federal awarding agency and pay the Federal Government for that percentage of the current fair market value of the property attributable to the Federal participation in the project (after deducting actual and reasonable selling and fix-up expenses, if any, from the sales proceeds). When the recipient is authorized or required to sell the property, proper...
sales procedures shall be established that provide for competition to the extent practicable and result in the highest possible return.

(3) The recipient may be directed to transfer title to the property to the Federal Government or to an eligible third party provided that, in such cases, the recipient shall be entitled to compensation for its attributable percentage of the current fair market value of the property.

___33 Federally-owned and exempt property.

(a) Federally-owned property.

(1) Title to federally-owned property remains vested in the Federal Government. Recipients shall submit annually an inventory listing of federally-owned property in their custody to the Federal awarding agency. Upon completion of the award or when the property is no longer needed, the recipient shall report the property to the Federal awarding agency for further Federal agency utilization.

(2) If the Federal awarding agency has no further need for the property, it shall be declared excess and reported to the General Services Administration, unless the Federal awarding agency has statutory authority to dispose of the property by alternative methods (e.g., the authority provided by the Federal Technology Transfer Act (15 U.S.C. 3710) to donate research equipment to educational and non-profit organizations in accordance with E.O. 12821, "Improving Mathematics and Science Education in Support of the National Education Goals.") Appropriate instructions shall be issued to the recipient by the Federal awarding agency.

(b) Exempt property. When statutory authority exists, the Federal awarding agency has the option to vest title to property acquired with Federal funds in the recipient without further obligation to the Federal Government and under conditions the Federal awarding agency considers appropriate. Such property is "exempt property." Should a Federal awarding agency not establish conditions, title to exempt property upon acquisition shall vest in the recipient without further obligation to the Federal Government.

___34 Equipment.

(a) Title to equipment acquired by a recipient with Federal funds shall vest in the recipient, subject to conditions of this section.

(b) The recipient shall not use equipment acquired with Federal funds to provide services to non-Federal outside organizations for a fee that is less than private companies charge for equivalent services, unless specifically authorized by Federal statute, for as long as the Federal Government retains an interest in the equipment.

(c) The recipient shall use the equipment in the project or program for which it was acquired as long as needed, whether or not the project or program continues to be supported by Federal funds and shall not encumber the property without approval of the Federal awarding agency. When no longer needed for the original project or program, the recipient shall use the equipment in connection with its other federally-sponsored activities, in the following order of priority: (i) Activities sponsored by the Federal awarding agency which funded the original project, then (ii) activities sponsored by other Federal awarding agencies.

(d) During the time that equipment is used on the project or program for which it was acquired, the recipient shall make it available for use on other projects or programs if such other use will not interfere with the work on the project or program for which the equipment was originally acquired. First preference for such other use shall be given to other projects or programs sponsored by the Federal awarding agency that financed the equipment; second preference shall be given to projects or programs sponsored by other Federal awarding agencies. If the equipment is owned by the Federal Government, use on other activities not sponsored by the Federal Government shall be permissible if authorized by the Federal awarding agency. User charges shall be treated as program income.

(e) When acquiring replacement equipment, the recipient may use the equipment to be replaced as trade-in or sell the equipment and use the proceeds to offset the costs of the replacement equipment subject to the approval of the Federal awarding agency.
(f) The recipient's property management standards for equipment acquired with Federal funds and federally-owned equipment shall include all of the following.

(1) Equipment records shall be maintained accurately and shall include the following information.

(i) A description of the equipment.

(ii) Manufacturer's serial number, model number, Federal stock number, national stock number, or other identification number.

(iii) Source of the equipment, including the award number.

(iv) Whether title vests in the recipient or the Federal Government.

(v) Acquisition date (or date received, if the equipment was furnished by the Federal Government) and cost.

(vi) Information from which one can calculate the percentage of Federal participation in the cost of the equipment (not applicable to equipment furnished by the Federal Government).

(vii) Location and condition of the equipment and the date the information was reported.

(viii) Unit acquisition cost.

(ix) Ultimate disposition data, including date of disposal and sales price or the method used to determine current fair market value where a recipient compensates the Federal awarding agency for its share.

(2) Equipment owned by the Federal Government shall be identified to indicate Federal ownership.

(3) A physical inventory of equipment shall be taken and the results reconciled with the equipment records at least once every two years. Any differences between quantities determined by the physical inspection and those shown in the accounting records shall be investigated to determine the causes of the difference. The recipient shall, in connection with the inventory, verify the existence, current utilization, and continued need for the equipment.

(4) A control system shall be in effect to insure adequate safeguards to prevent loss, damage, or theft of the equipment. Any loss, damage, or theft of equipment shall be investigated and fully documented; if the equipment was owned by the Federal Government, the recipient shall promptly notify the Federal awarding agency.

(5) Adequate maintenance procedures shall be implemented to keep the equipment in good condition.

(6) Where the recipient is authorized or required to sell the equipment, proper sales procedures shall be established which provide for competition to the extent practicable and result in the highest possible return.

(g) When the recipient no longer needs the equipment, the equipment may be used for other activities in accordance with the following standards. For equipment with a current per unit fair market value of $5000 or more, the recipient may retain the equipment for other uses provided that compensation is made to the original Federal awarding agency or its successor. The amount of compensation shall be computed by applying the percentage of Federal participation in the cost of the original project or program to the current fair market value of the equipment. If the recipient has no need for the equipment, the recipient shall request disposition instructions from the Federal awarding agency. The Federal awarding agency shall determine whether the equipment can be used to meet the agency's requirements. If no requirement exists within the agency, the availability of the equipment shall be reported to the General Services Administration by the Federal awarding agency to determine whether a requirement for the equipment exists in other Federal agencies. The Federal awarding agency shall issue instructions to the recipient no later than 120 calendar days after the recipient's request and the following procedures shall govern.

(1) If so instructed or if disposition instructions are not issued within 120 calendar days after the recipient's request, the recipient shall sell the equipment and reimburse the Federal awarding agency an amount computed by applying to the sales proceeds the percentage of Federal participation in the cost of the original project or program.
However, the recipient shall be permitted to deduct and retain from the Federal share $500 or ten percent of the proceeds, whichever is less, for the recipient's selling and handling expenses.

(2) If the recipient is instructed to ship the equipment elsewhere, the recipient shall be reimbursed by the Federal Government by an amount which is computed by applying the percentage of the recipient's participation in the cost of the original project or program to the current fair market value of the equipment, plus any reasonable shipping or interim storage costs incurred.

(3) If the recipient is instructed to otherwise dispose of the equipment, the recipient shall be reimbursed by the Federal awarding agency for such costs incurred in its disposition.

(4) The Federal awarding agency may reserve the right to transfer the title to the Federal Government or to a third party named by the Federal Government when such third party is otherwise eligible under existing statutes. Such transfer shall be subject to the following standards.

(i) The equipment shall be appropriately identified in the award or otherwise made known to the recipient in writing.

(ii) The Federal awarding agency shall issue disposition instructions within 120 calendar days after receipt of a final inventory. The final inventory shall list all equipment acquired with grant funds and federally-owned equipment. If the Federal awarding agency fails to issue disposition instructions within the 120 calendar day period, the recipient shall apply the standards of this section, as appropriate.

(iii) When the Federal awarding agency exercises its right to take title, the equipment shall be subject to the provisions for federally-owned equipment.

--- Supplies and other expendable property.

(a) Title to supplies and other expendable property shall vest in the recipient upon acquisition. If there is a residual inventory of unused supplies exceeding $5000 in total aggregate value upon termination or completion of the project or program and the supplies are not needed for any other federally-sponsored project or program, the recipient shall retain the supplies for use on non-Federal sponsored activities or sell them, but shall, in either case, compensate the Federal Government for its share. The amount of compensation shall be computed in the same manner as for equipment.

(b) The recipient shall not use supplies acquired with Federal funds to provide services to non-Federal outside organizations for a fee that is less than private companies charge for equivalent services, unless specifically authorized by Federal statute as long as the Federal Government retains an interest in the supplies.

--- Intangible property.

(a) The recipient may copyright any work that is subject to copyright and was developed, or for which ownership was purchased, under an award. The Federal awarding agency(ies) reserve a royalty-free, nonexclusive and irrevocable right to reproduce, publish, or otherwise use the work for Federal purposes, and to authorize others to do so.

(b) Recipients are subject to applicable regulations governing patents and inventions, including government-wide regulations issued by the Department of Commerce at 37 CFR part 401, "Rights to Inventions Made by Nonprofit Organizations and Small Business Firms Under Government Grants, Contracts and Cooperative Agreements."

(c) The Federal Government has the right to:

   (1) obtain, reproduce, publish or otherwise use the data first produced under an award; and

   (2) authorize others to receive, reproduce, publish, or otherwise use such data for Federal purposes.

(d) (1) In addition, in response to a Freedom of Information Act (FOIA) request for research data relating to published research findings produced under an award that were used by the Federal Government in developing an
agency action that has the force and effect of law, the Federal awarding agency shall request, and the recipient shall provide, within a reasonable time, the research data so that they can be made available to the public through the procedures established under the FOIA. If the Federal awarding agency obtains the research data solely in response to a FOIA request, the agency may charge the requester a reasonable fee equaling the full incremental cost of obtaining the research data. This fee should reflect costs incurred by the agency, the recipient, and applicable subrecipients. This fee is in addition to any fees the agency may assess under the FOIA (5 U.S.C. 552(a)(4)(A)).

(2) The following definitions apply for purposes of paragraph (d) of this section:

(i) Research data is defined as the recorded factual material commonly accepted in the scientific community as necessary to validate research findings, but not any of the following: preliminary analyses, drafts of scientific papers, plans for future research, peer reviews, or communications with colleagues. This "recorded" material excludes physical objects (e.g., laboratory samples). Research data also do not include:

(A) Trade secrets, commercial information, materials necessary to be held confidential by a researcher until they are published, or similar information which is protected under law; and

(B) Personnel and medical information and similar information the disclosure of which would constitute a clearly unwarranted invasion of personal privacy, such as information that could be used to identify a particular person in a research study.

(ii) Published is defined as either when:

(A) Research findings are published in a peer-reviewed scientific or technical journal; or

(B) A Federal agency publicly and officially cites the research findings in support of an agency action that has the force and effect of law.

(iii) Used by the Federal Government in developing an agency action that has the force and effect of law is defined as when an agency publicly and officially cites the research findings in support of an agency action that has the force and effect of law.

(e) Title to intangible property and debt instruments acquired under an award or subaward vests upon acquisition in the recipient. The recipient shall use that property for the originally-authorized purpose, and the recipient shall not encumber the property without approval of the Federal awarding agency. When no longer needed for the originally authorized purpose, disposition of the intangible property shall occur in accordance with the provisions of paragraph ___.34(g).

---  .37 Property trust relationship. Real property, equipment, intangible property and debt instruments that are acquired or improved with Federal funds shall be held in trust by the recipient as trustee for the beneficiaries of the project or program under which the property was acquired or improved. Agencies may require recipients to record liens or other appropriate notices of record to indicate that personal or real property has been acquired or improved with Federal funds and that use and disposition conditions apply to the property.

**Procurement Standards**

---  .40 Purpose of procurement standards. Sections ___.41 through ___.48 set forth standards for use by recipients in establishing procedures for the procurement of supplies and other expendable property, equipment, real property and other services with Federal funds. These standards are furnished to ensure that such materials and services are obtained in an effective manner and in compliance with the provisions of applicable Federal statutes and executive orders. No additional procurement standards or requirements shall be imposed by the Federal awarding agencies upon recipients, unless specifically required by Federal statute or executive order or approved by OMB.

---  .41 Recipient responsibilities. The standards contained in this section do not relieve the recipient of the contractual responsibilities arising under its contract(s). The recipient is the responsible authority, without recourse to the Federal awarding agency, regarding the settlement and satisfaction of all contractual and administrative issues arising out of procurements entered into in support of an award or other agreement. This includes disputes,
claims, protests of award, source evaluation or other matters of a contractual nature. Matters concerning violation of statute are to be referred to such Federal, State or local authority as may have proper jurisdiction.

____.42 Codes of conduct. The recipient shall maintain written standards of conduct governing the performance of its employees engaged in the award and administration of contracts. No employee, officer, or agent shall participate in the selection, award, or administration of a contract supported by Federal funds if a real or apparent conflict of interest would be involved. Such a conflict would arise when the employee, officer, or agent, any member of his or her immediate family, his or her partner, or an organization which employs or is about to employ any of the parties indicated herein, has a financial or other interest in the firm selected for an award. The officers, employees, and agents of the recipient shall neither solicit nor accept gratuities, favors, or anything of monetary value from contractors, or parties to subagreements. However, recipients may set standards for situations in which the financial interest is not substantial or the gift is an unsolicited item of nominal value. The standards of conduct shall provide for disciplinary actions to be applied for violations of such standards by officers, employees, or agents of the recipient.

____.43 Competition. All procurement transactions shall be conducted in a manner to provide, to the maximum extent practical, open and free competition. The recipient shall be alert to organizational conflicts of interest as well as noncompetitive practices among contractors that may restrict or eliminate competition or otherwise restrain trade. In order to ensure objective contractor performance and eliminate unfair competitive advantage, contractors that develop or draft specifications, requirements, statements of work, invitations for bids and/or requests for proposals shall be excluded from competing for such procurements. Awards shall be made to the bidder or offeror whose bid or offer is responsive to the solicitation and is most advantageous to the recipient, price, quality and other factors considered. Solicitations shall clearly set forth all requirements that the bidder or offeror shall fulfill in order for the bid or offer to be evaluated by the recipient. Any and all bids or offers may be rejected when it is in the recipient's interest to do so.

____.44 Procurement procedures.

(a) All recipients shall establish written procurement procedures. These procedures shall provide for, at a minimum, that (1), (2) and (3) apply.

(1) Recipients avoid purchasing unnecessary items.

(2) Where appropriate, an analysis is made of lease and purchase alternatives to determine which would be the most economical and practical procurement for the Federal Government.

(3) Solicitations for goods and services provide for all of the following.

(i) A clear and accurate description of the technical requirements for the material, product or service to be procured. In competitive procurements, such a description shall not contain features which unduly restrict competition.

(ii) Requirements which the bidder/offeror must fulfill and all other factors to be used in evaluating bids or proposals.

(iii) A description, whenever practicable, of technical requirements in terms of functions to be performed or performance required, including the range of acceptable characteristics or minimum acceptable standards.

(iv) The specific features of "brand name or equal" descriptions that bidders are required to meet when such items are included in the solicitation.

(v) The acceptance, to the extent practicable and economically feasible, of products and services dimensioned in the metric system of measurement.

(vi) Preference, to the extent practicable and economically feasible, for products and services that conserve natural resources and protect the environment and are energy efficient.
(b) Positive efforts shall be made by recipients to utilize small businesses, minority-owned firms, and women's business enterprises, whenever possible. Recipients of Federal awards shall take all of the following steps to further this goal.

(1) Ensure that small businesses, minority-owned firms, and women's business enterprises are used to the fullest extent practicable.

(2) Make information on forthcoming opportunities available and arrange time frames for purchases and contracts to encourage and facilitate participation by small businesses, minority-owned firms, and women's business enterprises.

(3) Consider in the contract process whether firms competing for larger contracts intend to subcontract with small businesses, minority-owned firms, and women's business enterprises.

(4) Encourage contracting with consortiums of small businesses, minority-owned firms and women's business enterprises when a contract is too large for one of these firms to handle individually.

(5) Use the services and assistance, as appropriate, of such organizations as the Small Business Administration and the Department of Commerce's Minority Business Development Agency in the solicitation and utilization of small businesses, minority-owned firms and women's business enterprises.

(c) The type of procuring instruments used (e.g., fixed price contracts, cost reimbursable contracts, purchase orders, and incentive contracts) shall be determined by the recipient but shall be appropriate for the particular procurement and for promoting the best interest of the program or project involved. The "cost-plus-a-percentage-of-cost" or "percentage of construction cost" methods of contracting shall not be used.

(d) Contracts shall be made only with responsible contractors who possess the potential ability to perform successfully under the terms and conditions of the proposed procurement. Consideration shall be given to such matters as contractor integrity, record of past performance, financial and technical resources or accessibility to other necessary resources. In certain circumstances, contracts with certain parties are restricted by agencies' implementation of E.O.s 12549 and 12689, "Debarment and Suspension."

(e) Recipients shall, on request, make available for the Federal awarding agency, pre-award review and procurement documents, such as request for proposals or invitations for bids, independent cost estimates, etc., when any of the following conditions apply.

(1) A recipient's procurement procedures or operation fails to comply with the procurement standards in the Federal awarding agency's implementation of this Circular.

(2) The procurement is expected to exceed the small purchase threshold fixed at 41 U.S.C. 403 (11) (currently $25,000) and is to be awarded without competition or only one bid or offer is received in response to a solicitation.

(3) The procurement, which is expected to exceed the small purchase threshold, specifies a "brand name" product.

(4) The proposed award over the small purchase threshold is to be awarded to other than the apparent low bidder under a sealed bid procurement.

(5) A proposed contract modification changes the scope of a contract or increases the contract amount by more than the amount of the small purchase threshold.

.45 Cost and price analysis. Some form of cost or price analysis shall be made and documented in the procurement files in connection with every procurement action. Price analysis may be accomplished in various ways, including the comparison of price quotations submitted, market prices and similar indicia, together with discounts. Cost analysis is the review and evaluation of each element of cost to determine reasonableness, allocability and allowability.
_46 Procurement records. Procurement records and files for purchases in excess of the small purchase threshold shall include the following at a minimum: (a) basis for contractor selection, (b) justification for lack of competition when competitive bids or offers are not obtained, and (c) basis for award cost or price.

_47 Contract administration. A system for contract administration shall be maintained to ensure contractor conformance with the terms, conditions and specifications of the contract and to ensure adequate and timely follow up of all purchases. Recipients shall evaluate contractor performance and document, as appropriate, whether contractors have met the terms, conditions and specifications of the contract.

_48 Contract provisions. The recipient shall include, in addition to provisions to define a sound and complete agreement, the following provisions in all contracts. The following provisions shall also be applied to subcontracts.

(a) Contracts in excess of the small purchase threshold shall contain contractual provisions or conditions that allow for administrative, contractual, or legal remedies in instances in which a contractor violates or breaches the contract terms, and provide for such remedial actions as may be appropriate.

(b) All contracts in excess of the small purchase threshold shall contain suitable provisions for termination by the recipient, including the manner by which termination shall be effected and the basis for settlement. In addition, such contracts shall describe conditions under which the contract may be terminated for default as well as conditions where the contract may be terminated because of circumstances beyond the control of the contractor.

(c) Except as otherwise required by statute, an award that requires the contracting (or subcontracting) for construction or facility improvements shall provide for the recipient to follow its own requirements relating to bid guarantees, performance bonds, and payment bonds unless the construction contract or subcontract exceeds $100,000. For those contracts or subcontracts exceeding $100,000, the Federal awarding agency may accept the bonding policy and requirements of the recipient, provided the Federal awarding agency has made a determination that the Federal Government's interest is adequately protected. If such a determination has not been made, the minimum requirements shall be as follows.

1. A bid guarantee from each bidder equivalent to five percent of the bid price. The "bid guarantee" shall consist of a firm commitment such as a bid bond, certified check, or other negotiable instrument accompanying a bid as assurance that the bidder shall, upon acceptance of his bid, execute such contractual documents as may be required within the time specified.

2. A performance bond on the part of the contractor for 100 percent of the contract price. A "performance bond" is one executed in connection with a contract to secure fulfillment of all the contractor's obligations under such contract.

3. A payment bond on the part of the contractor for 100 percent of the contract price. A "payment bond" is one executed in connection with a contract to assure payment as required by statute of all persons supplying labor and material in the execution of the work provided for in the contract.

4. Where bonds are required in the situations described herein, the bonds shall be obtained from companies holding certificates of authority as acceptable sureties pursuant to 31 CFR part 223, "Surety Companies Doing Business with the United States."

(d) All negotiated contracts (except those for less than the small purchase threshold) awarded by recipients shall include a provision to the effect that the recipient, the Federal awarding agency, the Comptroller General of the United States, or any of their duly authorized representatives, shall have access to any books, documents, papers and records of the contractor which are directly pertinent to a specific program for the purpose of making audits, examinations, excerpts and transcriptions.

(e) All contracts, including small purchases, awarded by recipients and their contractors shall contain the procurement provisions of Appendix A to this Circular, as applicable.
Reports and Records

___.50 Purpose of reports and records. Sections ___.51 through ___.53 set forth the procedures for monitoring and reporting on the recipient’s financial and program performance and the necessary standard reporting forms. They also set forth record retention requirements.

___.51 Monitoring and reporting program performance.

(a) Recipients are responsible for managing and monitoring each project, program, subaward, function or activity supported by the award. Recipients shall monitor subawards to ensure subrecipients have met the audit requirements as delineated in Section ___.26.

(b) The Federal awarding agency shall prescribe the frequency with which the performance reports shall be submitted. Except as provided in paragraph ___.51(f), performance reports shall not be required more frequently than quarterly or, less frequently than annually. Annual reports shall be due 90 calendar days after the grant year; quarterly or semi-annual reports shall be due 30 days after the reporting period. The Federal awarding agency may require annual reports before the anniversary dates of multiple year awards in lieu of these requirements. The final performance reports are due 90 calendar days after the expiration or termination of the award.

(c) If inappropriate, a final technical or performance report shall not be required after completion of the project.

(d) When required, performance reports shall generally contain, for each award, brief information on each of the following.

(1) A comparison of actual accomplishments with the goals and objectives established for the period, the findings of the investigator, or both. Whenever appropriate and the output of programs or projects can be readily quantified, such quantitative data should be related to cost data for computation of unit costs.

(2) Reasons why established goals were not met, if appropriate.

(3) Other pertinent information including, when appropriate, analysis and explanation of cost overruns or high unit costs.

(e) Recipients shall not be required to submit more than the original and two copies of performance reports.

(f) Recipients shall immediately notify the Federal awarding agency of developments that have a significant impact on the award-supported activities. Also, notification shall be given in the case of problems, delays, or adverse conditions which materially impair the ability to meet the objectives of the award. This notification shall include a statement of the action taken or contemplated, and any assistance needed to resolve the situation.

(g) Federal awarding agencies may make site visits, as needed.

(h) Federal awarding agencies shall comply with clearance requirements of 5 CFR part 1320 when requesting performance data from recipients.

___.52 Financial reporting.

(a) The following forms or such other forms as may be approved by OMB are authorized for obtaining financial information from recipients.

(1) SF-269 or SF-269A, Financial Status Report.

(i) Each Federal awarding agency shall require recipients to use the SF-269 or SF-269A to report the status of funds for all nonconstruction projects or programs. A Federal awarding agency may, however, have the option of not requiring the SF-269 or SF-269A when the SF-270, Request for Advance or Reimbursement, or SF-272, Report of Federal Cash Transactions, is determined to provide adequate information to meet its needs, except that a final SF-269 or SF-269A shall be required at the completion of the project when the SF-270 is used only for advances.
(ii) The Federal awarding agency shall prescribe whether the report shall be on a cash or accrual basis. If the Federal awarding agency requires accrual information and the recipient's accounting records are not normally kept on the accrual basis, the recipient shall not be required to convert its accounting system, but shall develop such accrual information through best estimates based on an analysis of the documentation on hand.

(iii) The Federal awarding agency shall determine the frequency of the Financial Status Report for each project or program, considering the size and complexity of the particular project or program. However, the report shall not be required more frequently than quarterly or less frequently than annually. A final report shall be required at the completion of the agreement.

(iv) The Federal awarding agency shall require recipients to submit the SF-269 or SF-269A (an original and no more than two copies) no later than 30 days after the end of each specified reporting period for quarterly and semi-annual reports, and 90 calendar days for annual and final reports. Extensions of reporting due dates may be approved by the Federal awarding agency upon request of the recipient.


(i) When funds are advanced to recipients the Federal awarding agency shall require each recipient to submit the SF-272 and, when necessary, its continuation sheet, SF-272a. The Federal awarding agency shall use this report to monitor cash advanced to recipients and to obtain disbursement information for each agreement with the recipients.

(ii) Federal awarding agencies may require forecasts of Federal cash requirements in the "Remarks" section of the report.

(iii) When practical and deemed necessary, Federal awarding agencies may require recipients to report in the "Remarks" section the amount of cash advances received in excess of three days. Recipients shall provide short narrative explanations of actions taken to reduce the excess balances.

(iv) Recipients shall be required to submit not more than the original and two copies of the SF-272 15 calendar days following the end of each quarter. The Federal awarding agencies may require a monthly report from those recipients receiving advances totaling $1 million or more per year.

(v) Federal awarding agencies may waive the requirement for submission of the SF-272 for any one of the following reasons: (1) When monthly advances do not exceed $25,000 per recipient, provided that such advances are monitored through other forms contained in this section; (2) If, in the Federal awarding agency's opinion, the recipient's accounting controls are adequate to minimize excessive Federal advances; or, (3) When the electronic payment mechanisms provide adequate data.

(b) When the Federal awarding agency needs additional information or more frequent reports, the following shall be observed.

(1) When additional information is needed to comply with legislative requirements, Federal awarding agencies shall issue instructions to require recipients to submit such information under the "Remarks" section of the reports.

(2) When a Federal awarding agency determines that a recipient's accounting system does not meet the standards in Section __.21, additional pertinent information to further monitor awards may be obtained upon written notice to the recipient until such time as the system is brought up to standard. The Federal awarding agency, in obtaining this information, shall comply with report clearance requirements of 5 CFR part 1320.

(3) Federal awarding agencies are encouraged to shade out any line item on any report if not necessary.

(4) Federal awarding agencies may accept the identical information from the recipients in machine readable format or computer printouts or electronic outputs in lieu of prescribed formats.

(5) Federal awarding agencies may provide computer or electronic outputs to recipients when such expedites or contributes to the accuracy of reporting.
___ .53 Retention and access requirements for records.

(a) This section sets forth requirements for record retention and access to records for awards to recipients. Federal awarding agencies shall not impose any other record retention or access requirements upon recipients.

(b) Financial records, supporting documents, statistical records, and all other records pertinent to an award shall be retained for a period of three years from the date of submission of the final expenditure report or, for awards that are renewed quarterly or annually, from the date of the submission of the quarterly or annual financial report, as authorized by the Federal awarding agency. The only exceptions are the following.

(1) If any litigation, claim, or audit is started before the expiration of the 3-year period, the records shall be retained until all litigation, claims or audit findings involving the records have been resolved and final action taken.

(2) Records for real property and equipment acquired with Federal funds shall be retained for 3 years after final disposition.

(3) When records are transferred to or maintained by the Federal awarding agency, the 3-year retention requirement is not applicable to the recipient.

(4) Indirect cost rate proposals, cost allocations plans, etc. as specified in paragraph ___ .53(g).

(c) Copies of original records may be substituted for the original records if authorized by the Federal awarding agency.

(d) The Federal awarding agency shall request transfer of certain records to its custody from recipients when it determines that the records possess long term retention value. However, in order to avoid duplicate recordkeeping, a Federal awarding agency may make arrangements for recipients to retain any records that are continuously needed for joint use.

(e) The Federal awarding agency, the Inspector General, Comptroller General of the United States, or any of their duly authorized representatives, have the right of timely and unrestricted access to any books, documents, papers, or other records of recipients that are pertinent to the awards, in order to make audits, examinations, excerpts, transcripts and copies of such documents. This right also includes timely and reasonable access to a recipient’s personnel for the purpose of interview and discussion related to such documents. The rights of access in this paragraph are not limited to the required retention period, but shall last as long as records are retained.

(f) Unless required by statute, no Federal awarding agency shall place restrictions on recipients that limit public access to the records of recipients that are pertinent to an award, except when the Federal awarding agency can demonstrate that such records shall be kept confidential and would have been exempted from disclosure pursuant to the Freedom of Information Act (5 U.S.C. 552) if the records had belonged to the Federal awarding agency.

(g) Indirect cost rate proposals, cost allocations plans, etc. Paragraphs (g)(1) and (g)(2) apply to the following types of documents, and their supporting records: indirect cost rate computations or proposals, cost allocation plans, and any similar accounting computations of the rate at which a particular group of costs is chargeable (such as computer usage chargeback rates or composite fringe benefit rates).

(1) If submitted for negotiation. If the recipient submits to the Federal awarding agency or the subrecipient submits to the recipient the proposal, plan, or other computation to form the basis for negotiation of the rate, then the 3-year retention period for its supporting records starts on the date of such submission.

(2) If not submitted for negotiation. If the recipient is not required to submit to the Federal awarding agency or the subrecipient is not required to submit to the recipient the proposal, plan, or other computation for negotiation purposes, then the 3-year retention period for the proposal, plan, or other computation and its supporting records starts at the end of the fiscal year (or other accounting period) covered by the proposal, plan, or other computation.
Termination and Enforcement

___ .60 Purpose of termination and enforcement. Sections ___ .61 and ___ .62 set forth uniform suspension, termination and enforcement procedures.

___ .61 Termination.

(a) Awards may be terminated in whole or in part only if (1), (2) or (3) apply.

(1) By the Federal awarding agency, if a recipient materially fails to comply with the terms and conditions of an award.

(2) By the Federal awarding agency with the consent of the recipient, in which case the two parties shall agree upon the termination conditions, including the effective date and, in the case of partial termination, the portion to be terminated.

(3) By the recipient upon sending to the Federal awarding agency written notification setting forth the reasons for such termination, the effective date, and, in the case of partial termination, the portion to be terminated. However, if the Federal awarding agency determines in the case of partial termination that the reduced or modified portion of the grant will not accomplish the purposes for which the grant was made, it may terminate the grant in its entirety under either paragraphs (a)(1) or (2).

(b) If costs are allowed under an award, the responsibilities of the recipient referred to in paragraph ___ .71(a), including those for property management as applicable, shall be considered in the termination of the award, and provision shall be made for continuing responsibilities of the recipient after termination, as appropriate.

___ .62 Enforcement.

(a) Remedies for noncompliance. If a recipient materially fails to comply with the terms and conditions of an award, whether stated in a Federal statute, regulation, assurance, application, or notice of award, the Federal awarding agency may, in addition to imposing any of the special conditions outlined in Section ___ .14, take one or more of the following actions, as appropriate in the circumstances.

(1) Temporarily withhold cash payments pending correction of the deficiency by the recipient or more severe enforcement action by the Federal awarding agency.

(2) Disallow (that is, deny both use of funds and any applicable matching credit for) all or part of the cost of the activity or action not in compliance.

(3) Wholly or partly suspend or terminate the current award.

(4) Withhold further awards for the project or program.

(5) Take other remedies that may be legally available.

(b) Hearings and appeals. In taking an enforcement action, the awarding agency shall provide the recipient an opportunity for hearing, appeal, or other administrative proceeding to which the recipient is entitled under any statute or regulation applicable to the action involved.

(c) Effects of suspension and termination. Costs of a recipient resulting from obligations incurred by the recipient during a suspension or after termination of an award are not allowable unless the awarding agency expressly authorizes them in the notice of suspension or termination or subsequently. Other recipient costs during suspension or after termination which are necessary and not reasonably avoidable are allowable if (1) and (2) apply.

(1) The costs result from obligations which were properly incurred by the recipient before the effective date of suspension or termination, are not in anticipation of it, and in the case of a termination, are noncancellable.
(2) The costs would be allowable if the award were not suspended or expired normally at the end of the funding period in which the termination takes effect.

d) Relationship to debarment and suspension. The enforcement remedies identified in this section, including suspension and termination, do not preclude a recipient from being subject to debarment and suspension under E.O.s 12549 and 12689 and the Federal awarding agency implementing regulations (see Section ...13).

SUBPART D - After-the-Award Requirements

__.70 Purpose. Sections ___.71 through ___.73 contain closeout procedures and other procedures for subsequent disallowances and adjustments.

__.71 Closeout procedures.

(a) Recipients shall submit, within 90 calendar days after the date of completion of the award, all financial, performance, and other reports as required by the terms and conditions of the award. The Federal awarding agency may approve extensions when requested by the recipient.

(b) Unless the Federal awarding agency authorizes an extension, a recipient shall liquidate all obligations incurred under the award not later than 90 calendar days after the funding period or the date of completion as specified in the terms and conditions of the award or in agency implementing instructions.

(c) The Federal awarding agency shall make prompt payments to a recipient for allowable reimbursable costs under the award being closed out.

(d) The recipient shall promptly refund any balances of unobligated cash that the Federal awarding agency has advanced or paid and that is not authorized to be retained by the recipient for use in other projects. OMB Circular A-129 governs unreturned amounts that become delinquent debts.

(e) When authorized by the terms and conditions of the award, the Federal awarding agency shall make a settlement for any upward or downward adjustments to the Federal share of costs after closeout reports are received.

(f) The recipient shall account for any real and personal property acquired with Federal funds or received from the Federal Government in accordance with Sections ___.31 through ___.37.

(g) In the event a final audit has not been performed prior to the closeout of an award, the Federal awarding agency shall retain the right to recover an appropriate amount after fully considering the recommendations on disallowed costs resulting from the final audit.

__.72 Subsequent adjustments and continuing responsibilities.

(a) The closeout of an award does not affect any of the following.

(1) The right of the Federal awarding agency to disallow costs and recover funds on the basis of a later audit or other review.

(2) The obligation of the recipient to return any funds due as a result of later refunds, corrections, or other transactions.

(3) Audit requirements in Section ___.26.

(4) Property management requirements in Sections ___.31 through ___.37.

(5) Records retention as required in Section ___.53.

(b) After closeout of an award, a relationship created under an award may be modified or ended in whole or in part with the consent of the Federal awarding agency and the recipient, provided the responsibilities of the
recipient referred to in paragraph ___.73(a), including those for property management as applicable, are considered and provisions made for continuing responsibilities of the recipient, as appropriate.

___ .73 Collection of amounts due.

(a) Any funds paid to a recipient in excess of the amount to which the recipient is finally determined to be entitled under the terms and conditions of the award constitute a debt to the Federal Government. If not paid within a reasonable period after the demand for payment, the Federal awarding agency may reduce the debt by (1), (2) or (3).

(1) Making an administrative offset against other requests for reimbursements.

(2) Withholding advance payments otherwise due to the recipient.

(3) Taking other action permitted by statute.

(b) Except as otherwise provided by law, the Federal awarding agency shall charge interest on an overdue debt in accordance with 4 CFR Chapter II, "Federal Claims Collection Standards."
Appendix A

Contract Provisions

All contracts, awarded by a recipient including small purchases, shall contain the following provisions as applicable:


2. Copeland "Anti-Kickback" Act (18 U.S.C. 874 and 40 U.S.C. 276c) - All contracts and subgrants in excess of $2000 for construction or repair awarded by recipients and subrecipients shall include a provision for compliance with the Copeland "Anti-Kickback" Act (18 U.S.C. 874), as supplemented by Department of Labor regulations (29 CFR part 3, "Contractors and Subcontractors on Public Building or Public Work Financed in Whole or in Part by Loans or Grants from the United States"). The Act provides that each contractor or subrecipient shall be prohibited from inducing, by any means, any person employed in the construction, completion, or repair of public work, to give up any part of the compensation to which he is otherwise entitled. The recipient shall report all suspected or reported violations to the Federal awarding agency.

3. Davis-Bacon Act, as amended (40 U.S.C. 276a to a-7) - When required by Federal program legislation, all construction contracts awarded by the recipients and subrecipients of more than $2000 shall include a provision for compliance with the Davis-Bacon Act (40 U.S.C. 276a to a-7) and as supplemented by Department of Labor regulations (29 CFR part 5, "Labor Standards Provisions Applicable to Contracts Governing Federally Financed and Assisted Construction"). Under this Act, contractors shall be required to pay wages to laborers and mechanics at a rate not less than the minimum wages specified in a wage determination made by the Secretary of Labor. In addition, contractors shall be required to pay wages not less than once a week. The recipient shall place a copy of the current prevailing wage determination issued by the Department of Labor in each solicitation and the award of a contract shall be conditioned upon the acceptance of the wage determination. The recipient shall report all suspected or reported violations to the Federal awarding agency.

4. Contract Work Hours and Safety Standards Act (40 U.S.C. 327-333) - Where applicable, all contracts awarded by recipients in excess of $2000 for construction contracts and in excess of $2500 for other contracts that involve the employment of mechanics or laborers shall include a provision for compliance with Sections 102 and 107 of the Contract Work Hours and Safety Standards Act (40 U.S.C. 327-333), as supplemented by Department of Labor regulations (29 CFR part 5). Under Section 102 of the Act, each contractor shall be required to compute the wages of every mechanic and laborer on the basis of a standard work week of 40 hours. Work in excess of the standard work week is permissible provided that the worker is compensated at a rate of not less than 1 ½ times the basic rate of pay for all hours worked in excess of 40 hours in the work week. Section 107 of the Act is applicable to construction work and provides that no laborer or mechanic shall be required to work in surroundings or under working conditions which are unsanitary, hazardous or dangerous. These requirements do not apply to the purchases of supplies or materials or articles ordinarily available on the open market, or contracts for transportation or transmission of intelligence.

5. Rights to Inventions Made Under a Contract or Agreement - Contracts or agreements for the performance of experimental, developmental, or research work shall provide for the rights of the Federal Government and the recipient in any resulting invention in accordance with 37 CFR part 401, "Rights to Inventions Made by Nonprofit Organizations and Small Business Firms Under Government Grants, Contracts and Cooperative Agreements," and any implementing regulations issued by the awarding agency.

6. Clean Air Act (42 U.S.C. 7401 et seq.) and the Federal Water Pollution Control Act (33 U.S.C. 1251 et seq.), as amended - Contracts and subgrants of amounts in excess of $100,000 shall contain a provision that requires the recipient to agree to comply with all applicable standards, orders or regulations issued pursuant to the Clean Air Act (42 U.S.C. 7401 et seq.) and the Federal Water Pollution Control Act as amended (33 U.S.C. 1251 et seq.). Violations shall be reported to the Federal awarding agency and the Regional Office of the Environmental Protection Agency (EPA).

7. Byrd Anti-Lobbying Amendment (31 U.S.C. 1352) - Contractors who apply or bid for an award of $100,000 or more shall file the required certification. Each tier certifies to the tier above that it will not and has not used Federal
appropriated funds to pay any person or organization for influencing or attempting to influence an officer or
employee of any agency, a member of Congress, officer or employee of Congress, or an employee of a member of
Each tier shall also disclose any lobbying with non-Federal funds that takes place in connection with obtaining any
Federal award. Such disclosures are forwarded from tier to tier up to the recipient.

8. Debarment and Suspension (E.O.s 12549 and 12689) - No contract shall be made to parties listed on the
General Services Administration’s List of Parties Excluded from Federal Procurement or Nonprocurement Programs
in accordance with E.O.s 12549 and 12689, "Debarment and Suspension." This list contains the names of parties
debarred, suspended, or otherwise excluded by agencies, and contractors declared ineligible under statutory or
regulatory authority other than E.O. 12549. Contractors with awards that exceed the small purchase threshold shall
provide the required certification regarding its exclusion status and that of its principal employees.
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**Appendix A to Part 84--Contract Provisions**

Authority: 42 U.S.C. 3535(d).

Source: 59 FR 47011, Sept. 13, 1994, unless otherwise noted.
Subpart A--General

Sec. 84.1 Purpose.
This part establishes uniform administrative requirements for Federal grants and agreements awarded to institutions of higher education, hospitals, and other non-profit organizations. Additional or inconsistent requirements shall not be imposed, except as provided in Secs. 84.4, and 84.14 or unless specifically required by Federal statute or executive order. Non-profit organizations that implement Federal programs for the States are also subject to State requirements.

Sec. 84.2 Definitions.
Accrued expenditures means the charges incurred by the recipient during a given period requiring the provision of funds for:
1. Goods and other tangible property received;
2. Services performed by employees, contractors, subrecipients, and other payees; and
3. Other amounts becoming owed under programs for which no current services or performance is required.

Accrued income means the sum of:
1. Earnings during a given period from:
   i. Services performed by the recipient; and
   ii. Goods and other tangible property delivered to purchasers; and
2. Amounts becoming owed to the recipient for which no current services or performance is required by the recipient.

Acquisition cost of equipment means the net invoice price of the equipment, including the cost of modifications, attachments, accessories, or auxiliary apparatus necessary to make the property usable for the purpose for which it was acquired. Other charges, such as the cost of installation, transportation, taxes, duty or protective in-transit insurance, shall be included or excluded from the unit acquisition cost in accordance with the recipient's regular accounting practices.

Advance means a payment made by Treasury check or other appropriate payment mechanism to a recipient upon its request either before outlays are made by the recipient or through the use of predetermined payment schedules.

Award means financial assistance that provides support or stimulation to accomplish a public purpose. Awards include grants and other agreements in the form of money or property in lieu of money, by HUD to an eligible recipient. The term does not include: technical assistance, which provides services instead of money; other assistance in the form of loans, loan guarantees, capital advances under the Sections 202 and 811 programs, interest subsidies, or insurance; direct payments of any kind to individuals; and, contracts which are required to be entered into and administered under procurement laws and regulations.

Cash contributions means the recipient's cash outlay, including the outlay of money contributed to the recipient by third parties.

Closeout means the process by which HUD determines that all applicable administrative actions and all required work of the award have been completed by the recipient and HUD.

Contract means a procurement contract under an award or subaward, and a procurement subcontract under a recipient's or subrecipient's contract.

Cost sharing or matching means that portion of project or program costs not borne by HUD.

Date of completion means the date on which all work under an award is completed or the date on the award document, or any supplement or amendment thereto, on which HUD sponsorship ends.

Disallowed costs means those charges to an award that HUD determines to be unallowable, in accordance with the applicable Federal cost principles or other terms and conditions contained in the award.
Equipment means tangible nonexpendable personal property including exempt property charged directly to the award having a useful life of more than one year and an acquisition cost of $5000 or more per unit. However, consistent with recipient policy, lower limits may be established.

Excess property means property under the control of HUD that, as determined by the Secretary, is no longer required for its needs or the discharge of its responsibilities.

Exempt property means tangible personal property acquired in whole or in part with Federal funds, where HUD has statutory authority to vest title in the recipient without further obligation to the Federal Government. An example of exempt property authority is contained in the Federal Grant and Cooperative Agreement Act (31 U.S.C. 6306), for property acquired under an award to conduct basic or applied research by a non-profit institution of higher education or non-profit organization whose principal purpose is conducting scientific research.

Federal awarding agency means the Federal agency that provides an award to the recipient.

Federal funds authorized means the total amount of Federal funds obligated by HUD for use by the recipient. This amount may include any authorized carryover of unobligated funds from prior funding periods when permitted by HUD regulations or implementing instructions.

Federal share of real property, equipment, or supplies means that percentage of the property's acquisition costs and any improvement expenditures paid with Federal funds.

Funding period means the period of time when Federal funding is available for obligation by the recipient.

Intangible property and debt instruments means, but is not limited to, trademarks, copyrights, patents and patent applications and such property as loans, notes and other debt instruments, lease agreements, stock and other instruments of property ownership, whether considered tangible or intangible.

Obligations means the amounts of orders placed, contracts and grants awarded, services received and similar transactions during a given period that require payment by the recipient during the same or a future period.

Outlays or expenditures means charges made to the project or program. They may be reported on a cash or accrual basis. For reports prepared on a cash basis, outlays are the sum of cash disbursements for direct charges for goods and services, the amount of indirect expense charged, the value of third party in-kind contributions applied and the amount of cash advances and payments made to subrecipients. For reports prepared on an accrual basis, outlays are the sum of cash disbursements for direct charges for goods and services, the amount of indirect expense incurred, the value of in-kind contributions applied, and the net increase (or decrease) in the amounts owed by the recipient for goods and other property received, for services performed by employees, contractors, subrecipients and other payees and other amounts becoming owed under programs for which no current services or performance are required.

Personal property means property of any kind except real property. It may be tangible, having physical existence, or intangible, having no physical existence, such as copyrights, patents, or securities.

Prior approval means written approval by an authorized official evidencing prior consent.

Program income means gross income earned by the recipient that is directly generated by a supported activity or earned as a result of the award (see exclusions in Secs. 84.24 (e) and (h)). Program income includes, but is not limited to, income from fees for services performed, the use or rental of real or personal property acquired under federally-funded projects, the sale of commodities or items fabricated under an award, license fees and royalties on patents and copyrights, and interest on loans made with award funds. Interest earned on advances of Federal funds is not program income. Except as otherwise provided in HUD regulations or the terms and conditions of the award, program income does not include the receipt of principal on loans, rebates, credits, discounts, etc., or interest earned on any of them.

Project costs means all allowable costs, as set forth in the applicable Federal cost principles, incurred by a recipient and the value of the contributions made by third parties in accomplishing the objectives of the award during the project period.

Project period means the period established in the award document during which HUD sponsorship begins and ends.

Property means, unless otherwise stated, real property, equipment, intangible property and debt instruments.

Real property means land, including land improvements, structures and appurtenances thereto, but excludes movable machinery and equipment.
Recipient means an organization receiving financial assistance directly from HUD to carry out a project or program. The term includes public and private institutions of higher education, public and private hospitals, and other quasi-public and private non-profit organizations such as, but not limited to, community action agencies, research institutes, educational associations, and health centers. The term includes commercial organizations, international organizations when operating domestically (such as agencies of the United Nations) which are recipients, subrecipients, or contractors or subcontractors of recipients or subrecipients. The term does not include government-owned contractor-operated facilities or research centers providing continued support for mission-oriented, large-scale programs that are government-owned or controlled, or are designated as federally-funded research and development centers. The term does not include mortgagors that receive mortgages insured or held by HUD or mortgagors or project owners that receive capital advances from HUD under the Section 202 and 811 programs.

Research and development means all research activities, both basic and applied, and all development activities that are supported at universities, colleges, and other non-profit institutions. "Research" is defined as a systematic study directed toward fuller scientific knowledge or understanding of the subject studied. "Development" is the systematic use of knowledge and understanding gained from research directed toward the production of useful materials, devices, systems, or methods, including design and development of prototypes and processes. The term research also includes activities involving the training of individuals in research techniques where such activities utilize the same facilities as other research and development activities and where such activities are not included in the instruction function.

Small awards means a grant or cooperative agreement not exceeding $100,000 or the small purchase threshold fixed at 41 U.S.C. 403(11), whichever is greater.

Subaward means:

(1) An award of financial assistance in the form of money, or property in lieu of money, made under an award by a recipient to an eligible subrecipient or by a subrecipient to a lower tier subrecipient. The term includes financial assistance when provided by any legal agreement, even if the agreement is called a contract, but does not include procurement of goods and services nor does it include any form of assistance which is excluded from the definition of "award".

(2) For Community Development Block Grants, the term "subaward" does not include the arrangement whereby the prime recipient transfers funds to another entity and that entity is the project. A distinction is made between such a transfer for the furtherance of the prime recipient's goals and the transfer of funds to a subrecipient who carries out activities and is accountable to the prime recipient. For example, in a CDBG award where a prime recipient has as its program goal the revitalization of a downtown area, the funds transferred to a business in the downtown area to remodel its store would not be considered a subaward subject to this part 84.

Subrecipient means the legal entity to which a subaward is made and which is accountable to the recipient for the use of the funds provided. The term includes commercial organizations and international organizations operating domestically (such as agencies of the United Nations).

Supplies means all personal property excluding equipment, intangible property, and debt instruments as defined in this section, and inventions of a contractor conceived or first actually reduced to practice in the performance of work under a funding agreement ("subject inventions"), as defined in 37 CFR part 401, "Rights to Inventions Made by Nonprofit Organizations and Small Business Firms Under Government Grants, Contracts, and Cooperative Agreements."

Suspension means an action by HUD that temporarily withdraws HUD sponsorship under an award, pending corrective action by the recipient or pending a decision to terminate the award by HUD. Suspension of an award is a separate action from suspension under HUD regulations implementing E.O. 12549 and E.O. 12689, "Debarment and Suspension," at 24 CFR part 24.

Termination means the cancellation of HUD sponsorship, in whole or in part, under an agreement at any time prior to the date of completion.

Third party in-kind contributions means the value of non-cash contributions provided by non-Federal third parties. Third party in-kind contributions may be in the form of real property, equipment, supplies and other expendable property, and the value of goods and services directly benefiting and specifically identifiable to the project or program.
Unliquidated obligations, for financial reports prepared on a cash basis, means the amount of obligations incurred by the recipient that have not been paid. For reports prepared on an accrued expenditure basis, they represent the amount of obligations incurred by the recipient for which an outlay has not been recorded.

Unobligated balance means the portion of the funds authorized by HUD that has not been obligated by the recipient and is determined by deducting the cumulative obligations from the cumulative funds authorized.

Unrecovered indirect cost means the difference between the amount awarded and the amount which could have been awarded under the recipient's approved negotiated indirect cost rate.

Working capital advance means a procedure whereby funds are advanced to the recipient to cover its estimated disbursement needs for a given initial period.

Sec. 84.3 Effect on other issuances.
For awards subject to this part, all administrative requirements of codified program regulations, program manuals, handbooks and other nonregulatory materials which are inconsistent with the requirements of this part shall be superseded, except to the extent they are required by statute, or authorized in accordance with the deviations provision in Sec. 84.4.

Sec. 84.4 Deviations.
The Office of Management and Budget (OMB) may grant exceptions for classes of grants or recipients subject to the requirements of this rule when exceptions are not prohibited by statute. However, in the interest of maximum uniformity, exceptions from the requirements of this rule shall be permitted only in unusual circumstances. HUD may apply more restrictive requirements to a class of recipients when approved by OMB. HUD may apply less restrictive requirements when awarding small awards and when approved by OMB, except for those requirements which are statutory. Exceptions on a case-by-case basis may also be made by HUD.

Sec. 84.5 Subawards.
Unless sections of this part specifically exclude subrecipients from coverage, the provisions of this part shall be applied to subrecipients performing work under awards if such subrecipients are institutions of higher education, hospitals, commercial organizations and international organizations operating domestically, or other non-profit organizations. State, local and Federally recognized Indian tribal government subrecipients are subject to the provisions of regulations implementing the grants management common rule, “Administrative Requirements for Grants and Cooperative Agreements to State, Local and Federally Recognized Indian Tribal Governments,” (24 CFR part 85).
Subpart B--Pre-Award Requirements

Sec. 84.10 Purpose.

Sections 84.11 through 84.17 prescribe forms and instructions and other pre-award matters to be used in applying for HUD awards.

Sec. 84.11 Pre-award policies.

(a) Use of Grants and Cooperative Agreements, and Contracts. In each instance, HUD shall decide on the appropriate award instrument (i.e., grant, cooperative agreement, or contract). The Federal Grant and Cooperative Agreement Act (31 U.S.C. 6301-08) governs the use of grants, cooperative agreements and contracts. A grant or cooperative agreement shall be used only when the principal purpose of a transaction is to accomplish a public purpose of support or stimulation authorized by Federal statute. The statutory criterion for choosing between grants and cooperative agreements is that for the latter, “substantial involvement is expected between the executive agency and the State, local government, or other recipient when carrying out the activity contemplated in the agreement.” Contracts shall be used when the principal purpose is acquisition of property or services for the direct benefit or use of the Federal Government.

(b) Public Notice and Priority Setting. HUD shall notify the public of its intended funding priorities for discretionary grant programs, unless funding priorities are established by Federal statute.

Sec. 84.12 Forms for applying for Federal assistance.

(a) HUD shall comply with the applicable report clearance requirements of 5 CFR part 1320, “Controlling Paperwork Burdens on the Public,” with regard to all forms used by HUD in place of or as a supplement to the Standard Form 424 (SF-424) series.

(b) Applicants shall use the SF-424 series or those forms and instructions prescribed by HUD.

(c) For Federal programs covered by E.O. 12372, “Intergovernmental Review of Federal Programs,” the applicant shall complete the appropriate sections of the SF-424 (Application for Federal Assistance) indicating whether the application was subject to review by the State Single Point of Contact (SPOC). The name and address of the SPOC for a particular State can be obtained from the Catalog of Federal Domestic Assistance. The SPOC shall advise the applicant whether the program for which application is made has been selected by that State for review.

Sec. 84.13 Debarment and suspension; Drug-Free Workplace.

(a) HUD and its recipients and subrecipients shall comply with the nonprocurement debarment and suspension common rule implementing E.O.s 12549 and 12689, “Debarment and Suspension,” at 24 CFR part 24. This common rule restricts subawards and contracts with certain parties that are debarred, suspended or otherwise excluded from or ineligible for participation in Federal assistance programs or activities.

(b) HUD and its recipients and subrecipients shall comply with the certification requirements of the Drug-Free Workplace Act of 1988 (42 U.S.C. 701), as set forth at 24 CFR part 24, subpart F.

Sec. 84.14 Special award conditions.

If an applicant or recipient:

(a) Has a history of poor performance;

(b) Is not financially stable;

(c) Has a management system that does not meet the standards prescribed in this part;

(d) Has not conformed to the terms and conditions of a previous award; or

(e) Is not otherwise responsible,

HUD may impose additional requirements as needed, provided that such applicant or recipient is notified in writing as to: the nature of the additional requirements, the reason why the additional requirements are being imposed, the nature of the corrective action needed, the time allowed for completing the corrective actions, and the method for requesting reconsideration of the additional requirements imposed. Any special conditions shall be promptly removed once the conditions that prompted them have been corrected.
Sec. 84.15 Metric system of measurement.

The Metric Conversion Act, as amended by the Omnibus Trade and Competitiveness Act (15 U.S.C. 205) declares that the metric system is the preferred measurement system for U.S. trade and commerce. The Act requires each Federal agency to establish a date or dates in consultation with the Secretary of Commerce, when the metric system of measurement will be used in the agency's procurements, grants, and other business-related activities. Metric implementation may take longer where the use of the system is initially impractical or likely to cause significant inefficiencies in the accomplishment of federally-funded activities. HUD shall follow the provisions of E.O. 12770, "Metric Usage in Federal Government Programs."

Sec. 84.16 Resource Conservation and Recovery Act.

Under the Resource Conservation and Recovery Act (RCRA) (Pub. L. 94-580, 42 U.S.C. 6962), any State agency or agency of a political subdivision of a State which is using appropriated Federal funds must comply with Section 6002. Section 6002 requires that preference be given in procurement programs to the purchase of specific products containing recycled materials identified in guidelines developed by the Environmental Protection Agency (EPA) (40 CFR parts 247 through 254).

Accordingly, State and local institutions of higher education, hospitals, commercial organizations and international organizations when operating domestically, and non-profit organizations that receive direct Federal awards or other Federal funds shall give preference in their procurement programs funded with Federal funds to the purchase of recycled products pursuant to the EPA guidelines.

Sec. 84.17 Certifications and representations.

Unless prohibited by statute or codified regulation, HUD is authorized and encouraged to allow recipients to submit certifications and representations required by statute, executive order, or regulation on an annual basis, if the recipients have ongoing and continuing relationships with the agency. Annual certifications and representations shall be signed by responsible officials with the authority to ensure recipients' compliance with the pertinent requirements.

Subpart C--Post-Award Requirements

Financial and Program Management

Sec. 84.20 Purpose of financial and program management.

Sections 84.21 through 84.28 prescribe standards for financial management systems, methods for making payments and rules for: satisfying cost sharing and matching requirements, accounting for program income, budget revision approvals, making audits, determining allowability of cost, and establishing fund availability.

Sec. 84.21 Standards for financial management systems.

(a) HUD shall require recipients to relate financial data to performance data and develop unit cost information whenever practical.

(b) Recipients' financial management systems shall provide for the following:

(1) Accurate, current and complete disclosure of the financial results of each federally-sponsored project or program in accordance with the reporting requirements set forth in Sec. 84.52. If a recipient maintains its records on other than an accrual basis, the recipient shall not be required to establish an accrual accounting system. These recipients may develop such accrual data for their reports on the basis of an analysis of the documentation on hand.

(2) Records that identify adequately the source and application of funds for federally-sponsored activities. These records shall contain information pertaining to Federal awards, authorizations, obligations, unobligated balances, assets, outlays, income and interest.

(3) Effective control over and accountability for all funds, property and other assets. Recipients shall adequately safeguard all such assets and assure they are used solely for authorized purposes.
(4) Comparison of outlays with budget amounts for each award. Whenever appropriate, financial information should be related to performance and unit cost data.

(5) Written procedures to minimize the time elapsing between the transfer of funds to the recipient from the U.S. Treasury and the issuance or redemption of checks, warrants or payments by other means for program purposes by the recipient. To the extent that the provisions of the Cash Management Improvement Act (CMIA) (Pub. L. 101-453) govern, payment methods of State agencies, instrumentalities, and fiscal agents shall be consistent with CMIA Treasury-State Agreements or the CMIA default procedures codified at 31 CFR part 205, "Withdrawal of Cash from the Treasury for Advances under Federal Grant and Other Programs."

(6) Written procedures for determining the reasonableness, allocability and allowability of costs in accordance with the provisions of the applicable Federal cost principles and the terms and conditions of the award.

(7) Accounting records including cost accounting records that are supported by source documentation.

(c) Where the Federal Government guarantees or insures the repayment of money borrowed by the recipient, HUD, at its discretion, may require adequate bonding and insurance if the bonding and insurance requirements of the recipient are not deemed adequate to protect the interest of the Federal Government.

(d) HUD may require adequate fidelity bond coverage where the recipient lacks sufficient coverage to protect the Federal Government's interest.

(e) Where bonds are required in the situations described above, the bonds shall be obtained from companies holding certificates of authority as acceptable sureties, as prescribed in 31 CFR part 223, "Surety Companies Doing Business with the United States."

Sec. 84.22 Payment.

(a) Payment methods shall minimize the time elapsing between the transfer of funds from the United States Treasury and the issuance or redemption of checks, warrants, or payment by other means by the recipients. Payment methods of State agencies or instrumentalities shall be consistent with Treasury-State CMIA agreements or default procedures codified at 31 CFR part 205.

(b) Recipients are to be paid in advance, provided they maintain or demonstrate the willingness to maintain:

(1) Written procedures that minimize the time elapsing between the transfer of funds and disbursement by the recipient; and

(2) Financial management systems that meet the standards for fund control and accountability as established in Sec. 84.21. Cash advances to a recipient organization shall be limited to the minimum amounts needed and be timed to be in accordance with the actual, immediate cash requirements of the recipient organization in carrying out the purpose of the approved program or project. The timing and amount of cash advances shall be as close as is administratively feasible to the actual disbursements by the recipient organization for direct program or project costs and the proportionate share of any allowable indirect costs.

(c) Whenever possible, advances shall be consolidated to cover anticipated cash needs for all awards made by HUD to the recipient.

(1) Advance payment mechanisms include, but are not limited to, Treasury check and electronic funds transfer.

(2) Advance payment mechanisms are subject to 31 CFR part 205.

(3) Recipients shall be authorized to submit requests for advances and reimbursements at least monthly when electronic fund transfers are not used.

(d) Requests for Treasury check advance payment shall be submitted on SF-270, "Request for Advance or Reimbursement," or other forms as may be authorized by OMB. This form is not to be used when Treasury check advance payments are made to the recipient automatically through the use of a predetermined payment schedule or if precluded by special HUD instructions for electronic funds transfer.

(e) Reimbursement is the preferred method when the requirements in paragraph (b) of this section cannot be met. HUD may also use this method on any construction agreement, or if the major portion of the construction project is accomplished through private market financing or Federal loans, and the Federal assistance constitutes a minor portion of the project.

(1) When the reimbursement method is used, HUD shall make payment within 30 days after receipt of the billing, unless the billing is improper.
(2) Recipients shall be authorized to submit request for reimbursement at least monthly when electronic funds transfers are not used.

(f) If a recipient cannot meet the criteria for advance payments and HUD has determined that reimbursement is not feasible because the recipient lacks sufficient working capital, HUD may provide cash on a working capital advance basis. Under this procedure, HUD shall advance cash to the recipient to cover its estimated disbursement needs for an initial period generally geared to the awardee's disbursing cycle. Thereafter, HUD shall reimburse the recipient for its actual cash disbursements. The working capital advance method of payment shall not be used for recipients unwilling or unable to provide timely advances to their subrecipient to meet the subrecipient's actual cash disbursements.

(g) To the extent available, recipients shall disburse funds available from repayments to and interest earned on a revolving fund, program income, rebates, refunds, contract settlements, audit recoveries and interest earned on such funds before requesting additional cash payments.

(h) Unless otherwise required by statute, HUD shall not withhold payments for proper charges made by recipients at any time during the project period unless paragraphs (h)(1) or (h)(2) of this section apply.

(1) A recipient has failed to comply with the project objectives, the terms and conditions of the award, or Federal reporting requirements.

(2) The recipient or subrecipient is delinquent in a debt to the United States as defined in OMB Circular A-129, “Managing Federal Credit Programs.” Under such conditions, HUD may, upon reasonable notice, inform the recipient that payments shall not be made for obligations incurred after a specified date until the conditions are corrected or the indebtedness to the Federal Government is liquidated.

(i) Standards governing the use of banks and other institutions as depositories of funds advanced under awards are as follows.

(1) Except for situations described in paragraph (i)(2) of this section, HUD shall not require separate depository accounts for funds provided to a recipient or establish any eligibility requirements for depositories for funds provided to a recipient. However, recipients must be able to account for the receipt, obligation and expenditure of funds.

(2) Advances of Federal funds shall be deposited and maintained in insured accounts whenever possible.

(j) Consistent with the national goal of expanding the opportunities for women-owned and minority-owned business enterprises, recipients shall be encouraged to use women-owned and minority-owned banks (a bank which is owned at least 50 percent by women or minority group members).

(k) Recipients shall maintain advances of Federal funds in interest bearing accounts, unless paragraphs (k)(1), (k)(2), or (k)(3) of this section apply.

(1) The recipient receives less than $120,000 in Federal awards per year.

(2) The best reasonably available interest bearing account would not be expected to earn interest in excess of $250 per year on Federal cash balances.

(3) The depository would require an average or minimum balance so high that it would not be feasible within the expected Federal and non-Federal cash resources.

(l) For those entities where CMIA and its implementing regulations do not apply, interest earned on Federal advances deposited in interest bearing accounts shall be remitted annually to Department of Health and Human Services, Payment Management System, P.O. Box 6021, Rockville, MD 20852. In keeping with Electronic Funds Transfer rules (31 CFR part 206), interest should be remitted to the HHS Payment Management System through an electronic medium such as the FEDWIRE Deposit system. Recipients which do not have this capability should use a check. Interest amounts up to $250 per year may be retained by the recipient for administrative expense. State universities and hospitals shall comply with CMIA, as it pertains to interest. If an entity subject to CMIA uses its own funds to pay pre-award costs for discretionary awards without prior written approval from the Federal awarding agency, it waives its right to recover the interest under CMIA.

(m) Except as noted elsewhere in this rule, only the following forms shall be authorized for the recipients in requesting advances and reimbursements. Federal agencies shall not require more than an original and two copies of these forms.
(1) SF-270, Request for Advance or Reimbursement. HUD has adopted the SF-270 as a standard form for all nonconstruction programs when electronic funds transfer or predetermined advance methods are not used. HUD has the option of using this form for construction programs in lieu of the SF-271, "Outlay Report and Request for Reimbursement for Construction Programs."

(2) SF-271, Outlay Report and Request for Reimbursement for Construction Programs. HUD has adopted the SF-271 as the standard form to be used for requesting reimbursement for construction programs. However, HUD may substitute the SF-270 when HUD determines that it provides adequate information to meet Federal needs.

Sec. 84.23 Cost sharing or matching.

(a) All contributions, including cash and third party in-kind, shall be accepted as part of the recipient's cost sharing or matching when such contributions meet all of the following criteria.

(1) Are verifiable from the recipient's records.
(2) Are not included as contributions for any other federally-assisted project or program.
(3) Are necessary and reasonable for proper and efficient accomplishment of project or program objectives.
(4) Are allowable under the applicable cost principles.
(5) Are not paid by the Federal Government under another award, except where authorized by Federal statute to be used for cost sharing or matching.
(6) Are provided for in the approved budget when required by HUD.
(7) Conform to other provisions of this part, as applicable.

(b) Unrecovered indirect costs may be included as part of cost sharing or matching only with the prior approval of HUD.

(c) Values for recipient contributions of services and property shall be established in accordance with the applicable cost principles.

If HUD authorizes recipients to donate buildings or land for construction/facilities acquisition projects or long-term use, the value of the donated property for cost sharing or matching shall be the lesser of paragraphs (c)(1) or (c)(2) of this section.

(1) The certified value of the remaining life of the property recorded in the recipient's accounting records at the time of donation.

(2) The current fair market value. However, when there is sufficient justification, HUD may approve the use of the current fair market value of the donated property, even if it exceeds the certified value at the time of donation to the project.

(d) Volunteer services furnished by professional and technical personnel, consultants, and other skilled and unskilled labor may be counted as cost sharing or matching if the service is an integral and necessary part of an approved project or program. Rates for volunteer services shall be consistent with those paid for similar work in the recipient's organization. In those instances in which the required skills are not found in the recipient organization, rates shall be consistent with those paid for similar work in the labor market in which the recipient competes for the kind of services involved. In either case, paid fringe benefits that are reasonable, allowable, and allocable may be included in the valuation.

(e) When an employer other than the recipient furnishes the services of an employee, these services shall be valued at the employee's regular rate of pay (plus an amount of fringe benefits that are reasonable, allowable, and allocable, but exclusive of overhead costs), provided these services are in the same skill for which the employee is normally paid.

(f) Donated supplies may include such items as expendable equipment, office supplies, laboratory supplies or workshop and classroom supplies. Value assessed to donated supplies included in the cost sharing or matching share shall be reasonable and shall not exceed the fair market value of the property at the time of the donation.

(g) The method used for determining cost sharing or matching for donated equipment, buildings and land for which title passes to the recipient may differ according to the purpose of the award, if paragraphs (g)(1) or (g)(2) of this section apply.
(1) If the purpose of the award is to assist the recipient in the acquisition of equipment, buildings or land, the total value of the donated property may be claimed as cost sharing or matching.

(2) If the purpose of the award is to support activities that require the use of equipment, buildings or land, normally only depreciation or use charges for equipment and buildings may be made. However, the full value of equipment or other capital assets and fair rental charges for land may be allowed, provided that HUD has approved the charges.

(h) The value of donated property shall be determined in accordance with the usual accounting policies of the recipient, with the following qualifications.

(1) The value of donated land and buildings shall not exceed its fair market value at the time of donation to the recipient as established by an independent appraiser (e.g., certified real property appraiser or General Services Administration representative) and certified by a responsible official of the recipient.

(2) The value of donated equipment shall not exceed the fair market value of equipment of the same age and condition at the time of donation.

(3) The value of donated space shall not exceed the fair rental value of comparable space as established by an independent appraisal of comparable space and facilities in a privately-owned building in the same locality.

(4) The value of loaned equipment shall not exceed its fair rental value.

(5) The following requirements pertain to the recipient's supporting records for in-kind contributions from third parties.

(i) Volunteer services shall be documented and, to the extent feasible, supported by the same methods used by the recipient for its own employees.

(ii) The basis for determining the valuation for personal service, material, equipment, buildings and land shall be documented.

Sec. 84.24 Program income.

(a) HUD shall apply the standards set forth in this section in requiring recipient organizations to account for program income related to projects financed in whole or in part with Federal funds.

(b) Except as provided in paragraph (h) of this section, program income earned during the project period shall be retained by the recipient and, in accordance with HUD regulations or the terms and conditions of the award, shall be used in one or more of the ways listed in the following.

(1) Added to funds committed to the project by HUD and recipient and used to further eligible project or program objectives.

(2) Used to finance the non-Federal share of the project or program.

(3) Deducted from the total project or program allowable cost in determining the net allowable costs on which the Federal share of costs is based.

(c) When HUD authorizes the disposition of program income as described in paragraphs (b)(1) or (b)(2) of this section, program income in excess of any limits stipulated shall be used in accordance with paragraph (b)(3) of this section.

(d) In the event that HUD does not specify in its regulations or the terms and conditions of the award how program income is to be used, paragraph (b)(3) of this section shall apply automatically to all projects or programs except research. For awards that support research, paragraph (b)(1) of this section shall apply automatically unless HUD indicates in the terms and conditions another alternative on the award or the recipient is subject to special award conditions, as indicated in Sec. 84.14.

(e) Unless HUD regulations or the terms and conditions of the award provide otherwise, recipients shall have no obligation to the Federal Government regarding program income earned after the end of the project period.

(f) If authorized by HUD regulations or the terms and conditions of the award, costs incident to the generation of program income may be deducted from gross income to determine program income, provided these costs have not been charged to the award.

(g) Proceeds from the sale of property shall be handled in accordance with the requirements of the Property Standards (See Secs. 84.30 through 84.37).
(h) Unless HUD regulations or the terms and condition of the award provide otherwise, recipients shall have no obligation to the Federal Government with respect to program income earned from license fees and royalties for copyrighted material, patents, patent applications, trademarks, and inventions produced under an award. However, Patent and Trademark Amendments (35 U.S.C. 18) apply to inventions made under an experimental, developmental, or research award.

Sec. 84.25 Revision of budget and program plans.

(a) The budget plan is the financial expression of the project or program as approved during the award process. It may include either the Federal and non-Federal share, or only the Federal share, depending upon HUD requirements. It shall be related to performance for program evaluation purposes whenever appropriate.

(b) Recipients are required to report deviations from budget and program plans, and request prior approvals for budget and program plan revisions, in accordance with this section.

(c) For nonconstruction awards, recipients shall request prior approvals from HUD for one or more of the following program or budget related reasons.

(1) Change in the scope or the objective of the project or program (even if there is no associated budget revision requiring prior written approval).

(2) Change in a key person specified in the application or award document.

(3) The absence for more than three months, or a 25 percent reduction in time devoted to the project, by the approved project director or principal investigator.

(4) The need for additional Federal funding.

(5) The transfer of amounts budgeted for indirect costs to absorb increases in direct costs, or vice versa, if approval is required by HUD.


(7) The transfer of funds allotted for training allowances (direct payment to trainees) to other categories of expense.

(8) Unless described in the application and funded in the approved awards, the subaward, transfer or contracting out of any work under an award. This provision does not apply to the purchase of supplies, material, equipment or general support services.

(d) No other prior approval requirements for specific items may be imposed unless a deviation has been approved by OMB.

(e) Except for requirements listed in paragraphs (c)(1) and (c)(4) of this section, HUD is authorized, at its option, to waive cost-related and administrative prior written approvals required by Circular A-110 and OMB Circulars A-21 and A-122. Such waivers may include authorizing recipients to do any one or more of the following.

(1) Incurred pre-award costs 90 calendar days prior to award or more than 90 calendar days with the prior approval of HUD. All pre-award costs are incurred at the recipient's risk (i.e., HUD is under no obligation to reimburse such costs if for any reason the recipient does not receive an award or if the award is less than anticipated and inadequate to cover such costs).

(2) Initiate a one-time extension of the expiration date of the award of up to 12 months unless one or more of the following conditions apply. For one-time extensions, the recipient must notify HUD in writing with the supporting reasons and revised expiration date at least 10 days before the expiration date specified in the award. This one-time extension may not be exercised merely for the purpose of using unobligated balances.

(i) The terms and conditions of award prohibit the extension.

(ii) The extension requires additional Federal funds.

(iii) The extension involves any change in the approved objectives or scope of the project.

(3) Carry forward unobligated balances to subsequent funding periods.
(4) For awards that support research, unless HUD provides otherwise in HUD's regulations, the prior approval requirements described in paragraph (e) of this section are automatically waived (i.e., recipients need not obtain such prior approvals) unless one of the conditions included in paragraph (e)(2) of this section applies.

(f) HUD may, at its option, restrict the transfer of funds among direct cost categories or programs, functions and activities for awards in which the Federal share of the project exceeds $100,000 and the cumulative amount of such transfers exceeds or is expected to exceed 10 percent of the total budget as last approved by HUD. HUD shall not permit a transfer that would cause any Federal appropriation or part thereof to be used for purposes other than those consistent with the original intent of the appropriation.

(g) All other changes to nonconstruction budgets, except for the changes described in paragraph (j) of this section, do not require prior approval.

(h) For construction awards, recipients shall request prior written approval promptly from HUD for budget revisions whenever paragraphs (h)(1), (h)(2) or (h)(3) of this section apply.

1. The revision results from changes in the scope or the objective of the project or program.

2. The need arises for additional Federal funds to complete the project.

3. A revision is desired which involves specific costs for which prior written approval requirements may be imposed consistent with applicable OMB cost principles listed in Sec. 84.27.

(i) No other prior approval requirements for specific items may be imposed unless a deviation has been approved by OMB.

(j) When HUD makes an award that provides support for both construction and nonconstruction work, HUD may require the recipient to request prior approval from HUD before making any fund or budget transfers between the two types of work supported.

(k) For both construction and nonconstruction awards, HUD shall require recipients to notify HUD in writing promptly whenever the amount of Federal authorized funds is expected to exceed the needs of the recipient for the project period by more than $5000 or five percent of the Federal award, whichever is greater. This notification shall not be required if an application for additional funding is submitted for a continuation award.

(l) When requesting approval for budget revisions, recipients shall use the budget forms that were used in the application unless HUD indicates a letter of request suffices.

(m) Within 30 calendar days from the date of receipt of the request for budget revisions, HUD shall review the request and notify the recipient whether the budget revisions have been approved. If the revision is still under consideration at the end of 30 calendar days, HUD shall inform the recipient in writing of the date when the recipient may expect the decision.

Sec. 84.26 Non-Federal audits.

(a) Recipients and subrecipients that are institutions of higher education or other non-profit organization (including hospitals) shall be subject to the audit requirements contained in the Single Audit Act Amendments of 1996 (31 U.S.C. 7501-7507) and revised OMB Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations."

(1) Non-profit organizations subject to regulations in the part 200 and part 800 series of this title which receive awards subject to part 84 shall comply with the audit requirements of revised OMB Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations." For HUD programs, a non-profit organization is the mortgagor or owner (as these terms are defined in the regulations in the part 200 and part 800 series) and not a related or affiliated organization or entity.

(2) [Reserved]

(b) State and local governments shall be subject to the audit requirements contained in the Single Audit Act Amendments of 1996 (31 U.S.C. 7501-7507) and revised OMB Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations."

(c) For-profit hospitals not covered by the audit provisions of revised OMB Circular A-133 shall be subject to the audit requirements of the Federal awarding agencies.

(d) Commercial organizations shall be subject to the audit requirements of HUD or the prime recipient as incorporated into the award document.
Sec. 84.27 Allowable costs.

For each kind of recipient, there is a set of Federal principles for determining allowable costs. Allowability of costs shall be determined in accordance with the cost principles applicable to the entity incurring the costs. Thus, allowability of costs incurred by State, local or federally-recognized Indian tribal governments is determined in accordance with the provisions of OMB Circular A-87, "Cost Principles for State and Local Governments." The allowability of costs incurred by non-profit organizations is determined in accordance with the provisions of OMB Circular A-122, "Cost Principles for Non-Profit Organizations."

The allowability of costs incurred by institutions of higher education is determined in accordance with the provisions of OMB Circular A-21, "Cost Principles for Educational Institutions." The allowability of costs incurred by hospitals is determined in accordance with the provisions of Appendix E of 45 CFR part 74, "Principles for Determining Costs Applicable to Research and Development Under Grants and Contracts with Hospitals." The allowability of costs incurred by commercial organizations and those non-profit organizations listed in Attachment C to Circular A-122 is determined in accordance with the provisions of the Federal Acquisition Regulation (FAR) at 48 CFR part 31.

Sec. 84.28 Period of availability of funds.

Where a funding period is specified, a recipient may charge to the grant only allowable costs resulting from obligations incurred during the funding period and any pre-award costs authorized by HUD.

Property Standards

Sec. 84.30 Purpose of property standards.

Sections 84.31 through 84.37 set forth uniform standards governing management and disposition of property furnished by the Federal Government whose cost was charged to a project supported by a Federal award. HUD shall require recipients to observe these standards under awards and shall not impose additional requirements, unless specifically required by Federal statute. The recipient may use its own property management standards and procedures provided it observes the provisions of Secs. 84.31 through 84.37.

Sec. 84.31 Insurance coverage.

Recipients shall, at a minimum, provide the equivalent insurance coverage for real property and equipment acquired with Federal funds as provided to property owned by the recipient. Federally-owned property need not be insured unless required by the terms and conditions of the award.

Sec. 84.32 Real property.

HUD prescribes the following requirements for recipients concerning the use and disposition of real property acquired in whole or in part under awards:

(a) Title to real property shall vest in the recipient subject to the condition that the recipient shall use the real property for the authorized purpose of the project as long as it is needed and shall not encumber the property without approval of HUD.

(b) The recipient shall obtain written approval by HUD for the use of real property in other federally-sponsored projects when the recipient determines that the property is no longer needed for the purpose of the original project. Use in other projects shall be limited to those under federally-sponsored projects (i.e., awards) or programs that have purposes consistent with those authorized for support by HUD.

(c) When the real property is no longer needed as provided in paragraphs (a) and (b) of this section, the recipient shall request disposition instructions from HUD or its successor Federal awarding agency. HUD shall observe one or more of the following disposition instructions.

(1) The recipient may be permitted to retain title without further obligation to the Federal Government after it compensates the Federal Government for that percentage of the current fair market value of the property attributable to the Federal participation in the project.

(2) The recipient may be directed to sell the property under guidelines provided by HUD and pay the Federal Government for that percentage of the current fair market value of the property attributable to the Federal
participation in the project (after deducting actual and reasonable selling and fix-up expenses, if any, from the sales proceeds). When the recipient is authorized or required to sell the property, proper sales procedures shall be established that provide for competition to the extent practicable and result in the highest possible return.

(3) The recipient may be directed to transfer title to the property to the Federal Government or to an eligible third party provided that, in such cases, the recipient shall be entitled to compensation for its attributable percentage of the current fair market value of the property.

Sec. 84.33 Federally-owned and exempt property.

(a) Federally-owned property.

(1) Title to federally-owned property remains vested in the Federal Government. Recipients shall submit annually an inventory listing of federally-owned property in their custody to HUD. Upon completion of the award or when the property is no longer needed, the recipient shall report the property to HUD for further HUD utilization.

(2) If HUD has no further need for the property, it shall be declared excess and reported to the General Services Administration, unless HUD has statutory authority to dispose of the property by alternative methods (e.g., the authority provided by the Federal Technology Transfer Act (15 U.S.C. 3710 (I)) to donate research equipment to educational and non-profit organizations in accordance with E.O. 12821, “Improving Mathematics and Science Education in Support of the National Education Goals.”) Appropriate instructions shall be issued to the recipient by HUD.

(b) Exempt property. When statutory authority exists, HUD has the option to vest title to property acquired with Federal funds in the recipient without further obligation to the Federal Government and under conditions HUD considers appropriate. Such property is "exempt property." Should HUD not establish conditions, title to exempt property upon acquisition shall vest in the recipient without further obligation to the Federal Government.

Sec. 84.34 Equipment.

(a) Title to equipment acquired by a recipient with Federal funds shall vest in the recipient, subject to conditions of this section.

(b) The recipient shall not use equipment acquired with Federal funds to provide services to non-Federal outside organizations for a fee that is less than private companies charge for equivalent services, unless specifically authorized by Federal statute, for as long as the Federal Government retains an interest in the equipment.

(c) The recipient shall use the equipment in the project or program for which it was acquired as long as needed, whether or not the project or program continues to be supported by Federal funds and shall not encumber the equipment without approval of HUD. When the equipment is no longer needed for the original project or program, the recipient shall use the equipment in connection with its other federally-sponsored activities, in the following order of priority:

(1) Activities sponsored by HUD which funded the original project; then

(2) Activities sponsored by other Federal awarding agencies.

(d) During the time that equipment is used on the project or program for which it was acquired, the recipient shall make it available for use on other projects or programs if such other use will not interfere with the work on the project or program for which the equipment was originally acquired. First preference for such other use shall be given to other projects or programs sponsored by HUD that financed the equipment; second preference shall be given to projects or programs sponsored by other Federal awarding agencies. If the equipment is owned by the Federal Government, use on other activities not sponsored by the Federal Government shall be permissible if authorized by HUD. User charges shall be treated as program income.

(e) When acquiring replacement equipment, the recipient may use the equipment to be replaced as trade-in or sell the equipment and use the proceeds to offset the costs of the replacement equipment subject to the approval of HUD.

(f) The recipient's property management standards for equipment acquired with Federal funds and federally-owned equipment shall include all of the following:

(1) Equipment records shall be maintained accurately and shall include the following information.

(i) A description of the equipment.
(ii) Manufacturer's serial number, model number, Federal stock number, national stock number, or other identification number.

(iii) Source of the equipment, including the award number.

(iv) Whether title vests in the recipient or the Federal Government.

(v) Acquisition date (or date received, if the equipment was furnished by the Federal Government) and cost.

(vi) Information from which one can calculate the percentage of Federal participation in the cost of the equipment (not applicable to equipment furnished by the Federal Government).

(vii) Location and condition of the equipment and the date the information was reported.

(viii) Unit acquisition cost.

(ix) Ultimate disposition data, including date of disposal and sales price or the method used to determine current fair market value where a recipient compensates HUD for its share.

(2) Equipment owned by the Federal Government shall be identified to indicate Federal ownership.

(3) A physical inventory of equipment shall be taken and the results reconciled with the equipment records at least once every two years. Any differences between quantities determined by the physical inspection and those shown in the accounting records shall be investigated to determine the causes of the difference. The recipient shall, in connection with the inventory, verify the existence, current utilization, and continued need for the equipment.

(4) A control system shall be in effect to insure adequate safeguards to prevent loss, damage, or theft of the equipment. Any loss, damage, or theft of equipment shall be investigated and fully documented; if the equipment was owned by the Federal Government, the recipient shall promptly notify HUD.

(5) Adequate maintenance procedures shall be implemented to keep the equipment in good condition.

(6) Where the recipient is authorized or required to sell the equipment, proper sales procedures shall be established which provide for competition to the extent practicable and result in the highest possible return.

(g) When the recipient no longer needs the equipment, the equipment may be used for other activities in accordance with the following standards. For equipment with a current per unit fair market value of $5000 or more, the recipient may retain the equipment for other uses provided that compensation is made to HUD or its successor. The amount of compensation shall be computed by applying the percentage of Federal participation in the cost of the original project or program to the current fair market value of the equipment. If the recipient has no need for the equipment, the recipient shall request disposition instructions from HUD. HUD shall determine whether the equipment can be used to meet HUD's requirements. If no requirement exists within HUD, the availability of the equipment shall be reported to the General Services Administration by HUD to determine whether a requirement for the equipment exists in other Federal agencies. HUD shall issue instructions to the recipient no later than 120 calendar days after the recipient's request and the following procedures shall govern.

(1) If so instructed or if disposition instructions are not issued within 120 calendar days after the recipient's request, the recipient shall sell the equipment and reimburse HUD an amount computed by applying to the sales proceeds the percentage of Federal participation in the cost of the original project or program. However, the recipient shall be permitted to deduct and retain from the Federal share $500 or ten percent of the proceeds, whichever is less, for the recipient's selling and handling expenses.

(2) If the recipient is instructed to ship the equipment elsewhere, the recipient shall be reimbursed by the Federal Government by an amount which is computed by applying the percentage of the recipient's participation in the cost of the original project or program to the current fair market value of the equipment, plus any reasonable shipping or interim storage costs incurred.

(3) If the recipient is instructed to otherwise dispose of the equipment, the recipient shall be reimbursed by HUD for such costs incurred in its disposition.

(4) HUD may reserve the right to transfer the title to the Federal Government or to a third party named by the Federal Government when such third party is otherwise eligible under existing statutes. Such transfer shall be subject to the following standards.

(i) The equipment shall be appropriately identified in the award or otherwise made known to the recipient in writing.
(ii) HUD shall issue disposition instructions within 120 calendar days after receipt of a final inventory. The final inventory shall list all equipment acquired with grant funds and federally-owned equipment. If HUD fails to issue disposition instructions within the 120 calendar day period, the recipient shall apply the standards of this section, as appropriate.

(iii) When HUD exercises its right to take title, the equipment shall be subject to the provisions for federally-owned equipment.

**Sec. 84.35 Supplies and other expendable property.**

(a) Title to supplies and other expendable property shall vest in the recipient upon acquisition. If there is a residual inventory of unused supplies exceeding $5000 in total aggregate value upon termination or completion of the project or program and the supplies are not needed for any other federally-sponsored project or program, the recipient shall retain the supplies for use on non-Federal sponsored activities or sell them, but shall, in either case, compensate the Federal Government for its share. The amount of compensation shall be computed in the same manner as for equipment.

(b) The recipient shall not use supplies acquired with Federal funds to provide services to non-Federal outside organizations for a fee that is less than private companies charge for equivalent services, unless specifically authorized by Federal statute, as long as the Federal Government retains an interest in the supplies.

**Sec. 84.36 Intangible property.**

(a) The recipient may copyright any work that is subject to copyright and was developed, or for which ownership was purchased, under an award. HUD reserves a royalty-free, nonexclusive and irrevocable right to reproduce, publish, or otherwise use the work for Federal purposes, and to authorize others to do so.

(b) Recipients are subject to applicable regulations governing patents and inventions, including government-wide regulations issued by the Department of Commerce at 37 CFR part 401, "Rights to Inventions Made by Nonprofit Organizations and Small Business Firms Under Government Grants, Contracts and Cooperative Agreements."

(c) HUD has the right to:

1. Obtain, reproduce, publish or otherwise use the data first produced under an award; and
2. Authorize others to receive, reproduce, publish, or otherwise use such data for HUD purposes.

(d)(1) In addition, in response to a Freedom of Information Act (FOIA) request for research data relating to published research findings produced under an award that were used by HUD in developing an agency action that has the force and effect of law, HUD shall request, and the recipient shall provide, within a reasonable time, the research data so that they can be made available to the public through the procedures established under the FOIA. If HUD obtains the research data solely in response to a FOIA request, HUD may charge the requester a reasonable fee equaling the full incremental cost of obtaining the research data. This fee should reflect costs incurred by HUD, the recipient, and applicable subrecipients. This fee is in addition to any fees HUD may assess under the FOIA (5 U.S.C. 552(a)(4)(A)).

(2) The following definitions apply for purposes of this paragraph (d):

(i) Research data is defined as the recorded factual material commonly accepted in the scientific community as necessary to validate research findings, but not any of the following: preliminary analyses, drafts of scientific papers, plans for future research, peer reviews, or communications with colleagues. This "recorded" material excludes physical objects (e.g., laboratory samples). Research data also do not include:

(A) Trade secrets, commercial information, materials necessary to be held confidential by a researcher until they are published, or similar information which is protected under law; and

(B) Personnel and medical information and similar information the disclosure of which would constitute a clearly unwarranted invasion of personal privacy, such as information that could be used to identify a particular person in a research study.

(ii) Published is defined as either when:

(A) Research findings are published in a peer-reviewed scientific or technical journal; or

(B) HUD publicly and officially cites the research findings in support of an agency action that has the force and effect of law.
(iii) Used by HUD in developing an agency action that has the force and effect of law is defined as when HUD publicly and officially cites the research findings in support of an agency action that has the force and effect of law.

(e) Title to intangible property and debt instruments acquired under an award or subaward vests upon acquisition in the recipient. The recipient shall use that property for the originally-authorized purpose, and the recipient shall not encumber the property without approval of HUD. When no longer needed for the originally authorized purpose, disposition of the intangible property shall occur in accordance with the provisions of Sec. 84.34(g).


Sec. 84.37 Property trust relationship.

Real property, equipment, intangible property and debt instruments that are acquired or improved with Federal funds shall be held in trust by the recipient as trustee for the beneficiaries of the project or program under which the property was acquired or improved. HUD may require recipients to record liens or other appropriate notices of record to indicate that personal or real property has been acquired or improved with Federal funds and that use and disposition conditions apply to the property.

Procurement Standards

Sec. 84.40 Purpose of procurement standards.

Sections 84.41 through 84.48 set forth standards for use by recipients in establishing procedures for the procurement of supplies and other expendable property, equipment, real property and other services with Federal funds. These standards are furnished to ensure that such materials and services are obtained in an effective manner and in compliance with the provisions of applicable Federal statutes and executive orders. No additional procurement standards or requirements shall be imposed by HUD upon recipients, unless specifically required by Federal statute or executive order or approved by OMB.

Sec. 84.41 Recipient responsibilities.

The standards contained in this section do not relieve the recipient of the contractual responsibilities arising under its contract(s). The recipient is the responsible authority, without recourse to HUD, regarding the settlement and satisfaction of all contractual and administrative issues arising out of procurements entered into in support of an award or other agreement. This includes disputes, claims, protests of award, source evaluation or other matters of a contractual nature. Matters concerning violation of statute are to be referred to such Federal, State or local authority as may have proper jurisdiction.

Sec. 84.42 Codes of conduct.

The recipient shall maintain written standards of conduct governing the performance of its employees engaged in the award and administration of contracts. No employee, officer, or agent shall participate in the selection, award, or administration of a contract supported by Federal funds if a real or apparent conflict of interest would be involved. Such a conflict would arise when the employee, officer, or agent, any member of his or her immediate family, his or her partner, or an organization which employs or is about to employ any of the parties indicated herein, has a financial or other interest in the firm selected for an award. The officers, employees, and agents of the recipient shall neither solicit nor accept gratuities, favors, or anything of monetary value from contractors, or parties to subagreements. However, recipients may set standards for situations in which the financial interest is not substantial or the gift is an unsolicited item of nominal value. The standards of conduct shall provide for disciplinary actions to be applied for violations of such standards by officers, employees, or agents of the recipient.

Sec. 84.43 Competition.

All procurement transactions shall be conducted in a manner to provide, to the maximum extent practical, open and free competition. The recipient shall be alert to organizational conflicts of interest as well as noncompetitive practices among contractors that may restrict or eliminate competition or otherwise restrain trade. In order to ensure objective contractor performance and eliminate unfair competitive advantage, contractors that develop or draft specifications, requirements, statements of work, invitations for bids and/or requests for proposals shall be excluded from competing for such procurements. Awards shall be made to the bidder or offeror whose bid or offer is responsive to the solicitation and is most advantageous to the recipient, price, quality and other factors.
considered. The other factors shall include the bidder's or offeror's compliance with Section 3 of the Housing and Urban Development Act of 1968 (12 U.S.C. 1701u), hereafter referred to as "Section 3." Section 3 provides that, to the greatest extent feasible, and consistent with existing Federal, State, and local laws, and regulations, economic opportunities generated by certain HUD financial assistance shall be directed to low- and very low-income persons. Solicitations shall clearly set forth all requirements that the bidder or offeror shall fulfill in order for the bid or offer to be evaluated by the recipient. Any and all bids or offers may be rejected when it is in the recipient's interest to do so.

**Sec. 84.44 Procurement procedures.**

(a) All recipients shall establish written procurement procedures. These procedures shall provide for, at a minimum, that paragraphs (a)(1), (a)(2) and (a)(3) of this section apply.

(1) Recipients avoid purchasing unnecessary items.

(2) Where appropriate, an analysis is made of lease and purchase alternatives to determine which would be the most economical and practical procurement for the Federal Government.

(3) Solicitations for goods and services provide for all of the following.

(i) A clear and accurate description of the technical requirements for the material, product or service to be procured. In competitive procurements, such a description shall not contain features which unduly restrict competition.

(ii) Requirements which the bidder/offeror must fulfill and all other factors to be used in evaluating bids or proposals.

(iii) A description, whenever practicable, of technical requirements in terms of functions to be performed or performance required, including the range of acceptable characteristics or minimum acceptable standards.

(iv) The specific features of "brand name or equal" descriptions that bidders are required to meet when such items are included in the solicitation.

(v) The acceptance, to the extent practicable and economically feasible, of products and services dimensioned in the metric system of measurement.

(vi) Preference, to the extent practicable and economically feasible, for products and services that conserve natural resources and protect the environment and are energy efficient.

(b) Positive efforts shall be made by recipients to utilize small businesses, minority-owned firms, and women's business enterprises, whenever possible. Recipients of Federal awards shall take all of the following steps to further this goal.

(1) Ensure that small businesses, minority-owned firms, and women's business enterprises are used to the fullest extent practicable.

(2) Make information on forthcoming opportunities available and arrange time frames for purchases and contracts to encourage and facilitate participation by small businesses, minority-owned firms, and women's business enterprises.

(3) Consider in the contract process whether firms competing for larger contracts intend to subcontract with small businesses, minority-owned firms, and women's business enterprises.

(4) Encourage contracting with consortiums of small businesses, minority-owned firms and women's business enterprises when a contract is too large for one of these firms to handle individually.

(5) Use the services and assistance, as appropriate, of such organizations as the Small Business Administration and the Department of Commerce's Minority Business Development Agency in the solicitation and utilization of small businesses, minority-owned firms and women's business enterprises.

(c) The type of procuring instruments used (e.g., fixed price contracts, cost reimbursable contracts, purchase orders, and incentive contracts) shall be determined by the recipient but shall be appropriate for the particular procurement and for promoting the best interest of the program or project involved. The "cost-plus-a-percentage-of-cost" or "percentage of construction cost" methods of contracting shall not be used.

(d) Contracts shall be made only with responsible contractors who possess the potential ability to perform successfully under the terms and conditions of the proposed procurement. Consideration shall be given to such
matters as contractor integrity; compliance with public policy, including, where applicable, Section 3 of the Housing and Urban Development Act of 1968 (12 U.S.C. 1701u); record of past performance; financial and technical resources or accessibility to other necessary resources. In certain circumstances, contracts with certain parties are restricted by implementation of E.O.s 12549 and 12689, “Debarment and Suspension,” at 24 CFR part 24.

(e) Recipients shall, on request, make available for the Federal awarding agency, pre-award review and procurement documents, such as requests for proposals or invitations for bids, independent cost estimates, etc., when any of the following conditions apply.

1. A recipient's procurement procedures or operation fails to comply with the procurement standards in HUD's implementation of Circular A-110.

2. The procurement is expected to exceed $100,000 or the small purchase threshold fixed at 41 U.S.C. 403 (11), whichever is greater, and is to be awarded without competition or only one bid or offer is received in response to a solicitation.

3. The procurement, which is expected to exceed the small purchase threshold, specifies a “brand name" product.

4. The proposed award over the small purchase threshold is to be awarded to other than the apparent low bidder under a sealed bid procurement.

5. A proposed contract modification changes the scope of a contract or increases the contract amount by more than the amount of the small purchase threshold.

Sec. 84.45 Cost and price analysis.

Some form of cost or price analysis shall be made and documented in the procurement files in connection with every procurement action. Price analysis may be accomplished in various ways, including the comparison of price quotations submitted, market prices and similar indicia, together with discounts. Cost analysis is the review and evaluation of each element of cost to determine reasonableness, allocability and allowability.

Sec. 84.46 Procurement records.

Procurement records and files for purchases in excess of the small purchase threshold shall include the following at a minimum:

1. Basis for contractor selection;

2. Justification for lack of competition when competitive bids or offers are not obtained; and

3. Basis for award cost or price.

Sec. 84.47 Contract administration.

A system for contract administration shall be maintained to ensure contractor conformance with the terms, conditions and specifications of the contract and to ensure adequate and timely follow up of all purchases. Recipients shall evaluate contractor performance and document, as appropriate, whether contractors have met the terms, conditions and specifications of the contract.

Sec. 84.48 Contract provisions.

The recipient shall include, in addition to provisions to define a sound and complete agreement, the following provisions in all contracts. The following provisions shall also be applied to subcontracts.

1. Contracts in excess of the small purchase threshold shall contain contractual provisions or conditions that allow for administrative, contractual, or legal remedies in instances in which a contractor violates or breaches the contract terms, and provide for such remedial actions as may be appropriate.

2. All contracts in excess of the small purchase threshold shall contain suitable provisions for termination by the recipient, including the manner by which termination shall be effected and the basis for settlement. In addition, such contracts shall describe conditions under which the contract may be terminated for default as well as conditions where the contract may be terminated because of circumstances beyond the control of the contractor.

3. Except as otherwise required by statute, an award that requires the contracting (or subcontracting) for construction or facility improvements shall provide for the recipient to follow its own requirements relating to bid
guarantees, performance bonds, and payment bonds unless the construction contract or subcontract exceeds $100,000. For those contracts or subcontracts exceeding $100,000, HUD may accept the bonding policy and requirements of the recipient, provided HUD has made a determination that the Federal Government's interest is adequately protected. If such a determination has not been made, the minimum requirements shall be as follows:

(1) A bid guarantee from each bidder equivalent to five percent of the bid price. The "bid guarantee" shall consist of a firm commitment such as a bid bond, certified check, or other negotiable instrument accompanying a bid as assurance that the bidder shall, upon acceptance of his bid, execute such contractual documents as may be required within the time specified.

(2) A performance bond on the part of the contractor for 100 percent of the contract price. A "performance bond" is one executed in connection with a contract to secure fulfillment of all the contractor's obligations under such contract.

(3) A payment bond on the part of the contractor for 100 percent of the contract price. A "payment bond" is one executed in connection with a contract to assure payment as required by statute of all persons supplying labor and material in the execution of the work provided for in the contract.

(4) Where bonds are required in the situations described herein, the bonds shall be obtained from companies holding certificates of authority as acceptable sureties pursuant to 31 CFR part 223, "Surety Companies Doing Business with the United States."

(d) All negotiated contracts (except those for less than the small purchase threshold) awarded by recipients shall include a provision to the effect that the recipient, HUD, the Comptroller General of the United States, or any of their duly authorized representatives, shall have access to any books, documents, papers and records of the contractor which are directly pertinent to a specific program for the purpose of making audits, examinations, excerpts and transcriptions.

(e) All contracts, including small purchases, awarded by recipients and their contractors shall contain the procurement provisions of Appendix A to this rule, as applicable.

Reports and Records

Sec. 84.50 Purpose of reports and records.

Sections 84.51 through 84.53 set forth the procedures for monitoring and reporting on the recipient's financial and program performance and the necessary standard reporting forms. They also set forth record retention requirements.

Sec. 84.51 Monitoring and reporting program performance.

(a) Recipients are responsible for managing and monitoring each project, program, subaward, function or activity supported by the award. Recipients shall monitor subawards to ensure subrecipients have met the audit requirements as delineated in Sec. 84.26.

(b) HUD shall prescribe the frequency with which the performance reports shall be submitted. Except as provided in Sec. 84.51(f), performance reports shall not be required more frequently than quarterly or less frequently than annually. Annual reports shall be due 90 calendar days after the grant year; quarterly or semi-annual reports shall be due 30 days after the reporting period. HUD may require annual reports before the anniversary dates of multiple year awards in lieu of these requirements. The final performance reports are due 90 calendar days after the expiration or termination of the award.

(c) If inappropriate, a final technical or performance report shall not be required after completion of the project.

(d) When required, performance reports shall generally contain, for each award, brief information on each of the following:

(1) A comparison of actual accomplishments with the goals and objectives established for the period, the findings of the investigator, or both. Whenever appropriate and the output of programs or projects can be readily quantified, such quantitative data should be related to cost data for computation of unit costs.

(2) Reasons why established goals were not met, if appropriate.

(3) Other pertinent information including, when appropriate, analysis and explanation of cost overruns or high unit costs.
(e) Recipients shall not be required to submit more than the original and two copies of performance reports.

(f) Recipients shall immediately notify HUD of developments that have a significant impact on the award-supported activities. Also, notification shall be given in the case of problems, delays, or adverse conditions which materially impair the ability to meet the objectives of the award. This notification shall include a statement of the action taken or contemplated, and any assistance needed to resolve the situation.

(g) HUD may make site visits, as needed.

(h) HUD shall comply with clearance requirements of 5 CFR part 1320 when requesting performance data from recipients.

Sec. 84.52 Financial reporting.

(a) The following forms or such other forms as may be approved by OMB are authorized for obtaining financial information from recipients.

(1) SF-269 or SF-269A, Financial Status Report.

   (i) HUD requires recipients to use the SF-269 or SF-269A to report the status of funds for all nonconstruction projects or programs. HUD has the option of not requiring the SF-269 or SF-269A when the SF-270, Request for Advance or Reimbursement, or SF-272, Report of Federal Cash Transactions, is determined to provide adequate information to meet its needs, except that a final SF-269 or SF-269A shall be required at the completion of the project when the SF-270 is used only for advances.

   (ii) HUD shall prescribe whether the report shall be on a cash or accrual basis. If HUD requires accrual information and the recipient's accounting records are not normally kept on the accrual basis, the recipient shall not be required to convert its accounting system, but shall develop such accrual information through best estimates based on an analysis of the documentation on hand.

   (iii) HUD shall determine the frequency of the Financial Status Report for each project or program, considering the size and complexity of the particular project or program. However, the report shall not be required more frequently than quarterly or less frequently than annually. A final report shall be required at the completion of the agreement.

   (iv) HUD requires recipients to submit the SF-269 or SF-269A (an original and no more than two copies) no later than 30 days after the end of each specified reporting period for quarterly and semi-annual reports, and 90 calendar days for annual and final reports. Extensions of reporting due dates may be approved by HUD upon request of the recipient.


   (i) When funds are advanced to recipients HUD shall require each recipient to submit the SF-272 and, when necessary, its continuation sheet, SF-272a. HUD shall use this report to monitor cash advanced to recipients and to obtain disbursement information for each agreement with the recipients.

   (ii) HUD may require forecasts of Federal cash requirements in the "Remarks" section of the report.

   (iii) When practical and deemed necessary, HUD may require recipients to report in the "Remarks" section the amount of cash advances received and retained in excess of three days. Recipients shall provide short narrative explanations of actions taken to reduce the excess balances.

   (iv) Recipients shall be required to submit not more than the original and two copies of the SF-272 15 calendar days following the end of each quarter. HUD may require a monthly report from those recipients receiving advances totaling $1 million or more per year.

   (v) HUD may waive the requirement for submission of the SF-272 for any one of the following reasons:

      (A) When monthly advances do not exceed $25,000 per recipient, provided that such advances are monitored through other forms contained in this section;

      (B) If, in HUD's opinion, the recipient's accounting controls are adequate to minimize excessive Federal advances; or

      (C) When the electronic payment mechanisms provide adequate data.

   (b) When HUD needs additional information or more frequent reports, the following shall be observed.
(1) When additional information is needed to comply with legislative requirements, HUD shall issue instructions to require recipients to submit such information under the "Remarks" section of the reports.

(2) When HUD determines that a recipient's accounting system does not meet the standards in Sec. 84.21, additional pertinent information to further monitor awards may be obtained upon written notice to the recipient until such time as the system is brought up to standard. HUD, in obtaining this information, shall comply with report clearance requirements of 5 CFR part 1320.

(3) HUD will shade out any line item on any report if not necessary.

(4) HUD may accept the identical information from the recipients in machine readable format or computer printouts or electronic outputs in lieu of prescribed formats.

(5) HUD may provide computer or electronic outputs to recipients when such expedites or contributes to the accuracy of reporting.

Sec. 84.53 Retention and access requirements for records.

(a) This section sets forth requirements for record retention and access to records for awards to recipients. HUD shall not impose any other record retention or access requirements upon recipients.

(b) Financial records, supporting documents, statistical records, and all other records pertinent to an award shall be retained for a period of three years from the date of submission of the final expenditure report or, for awards that are renewed quarterly or annually, from the date of the submission of the quarterly or annual financial report, as authorized by HUD. The only exceptions are the following.

(1) If any litigation, claim, or audit is started before the expiration of the 3-year period, the records shall be retained until all litigation, claims or audit findings involving the records have been resolved and final action taken.

(2) Records for real property and equipment acquired with Federal funds shall be retained for 3 years after final disposition.

(3) When records are transferred to or maintained by HUD, the 3-year retention requirement is not applicable to the recipient.

(4) Indirect cost rate proposals, cost allocation plans, etc. as specified in Sec. 84.53(g).

(c) Copies of original records may be substituted for the original records if authorized by HUD.

(d) HUD shall request transfer of certain records to its custody from recipients when it determines that the records possess long term retention value. However, in order to avoid duplicate recordkeeping, HUD may make arrangements for recipients to retain any records that are continuously needed for joint use.

(e) HUD, the Inspector General, Comptroller General of the United States, or any of their duly authorized representatives, have the right of timely and unrestricted access to any books, documents, papers, or other records of recipients that are pertinent to the awards, in order to make audits, examinations, excerpts, transcripts and copies of such documents. This right also includes timely and reasonable access to a recipient's personnel for the purpose of interview and discussion related to such documents. The rights of access in this paragraph (e) are not limited to the required retention period, but shall last as long as records are retained.

(f) Unless required by statute, HUD shall not place restrictions on recipients that limit public access to the records of recipients that are pertinent to an award, except when HUD can demonstrate that such records shall be kept confidential and would have been exempted from disclosure pursuant to the Freedom of Information Act (5 U.S.C. 552) if the records had belonged to HUD.

(g) Indirect cost rate proposals, cost allocation plans, etc. Paragraphs (g)(1) and (g)(2) of this section apply to the following types of documents, and their supporting records--indirect cost rate computations or proposals, cost allocation plans, and any similar accounting computations of the rate at which a particular group of costs is chargeable (such as computer usage chargeback rates or composite fringe benefit rates).

(1) If submitted for negotiation. If the recipient submits to HUD or the subrecipient submits to the participant the proposal, plan, or other computation to form the basis for negotiation of the rate, then the 3-year retention period for its supporting records starts on the date of such submission.

(2) If not submitted for negotiation. If the recipient is not required to submit to HUD or the subrecipient is not required to submit to the recipient the proposal, plan, or other computation for negotiation purposes, then the 3-
year retention period for the proposal, plan, or other computation and its supporting records starts at the end of the fiscal year (or other accounting period) covered by the proposal, plan, or other computation.

**Termination and Enforcement**

**Sec. 84.60  Purpose of termination and enforcement.**

Sections 84.61 and 84.62 set forth uniform suspension, termination and enforcement procedures.

**Sec. 84.61  Termination.**

(a) Awards may be terminated in whole or in part only if paragraphs (a)(1), (a)(2) or (a)(3) of this section apply.

(1) By HUD, if a recipient materially fails to comply with the terms and conditions of an award.

(2) By HUD with the consent of the recipient, in which case the two parties shall agree upon the termination conditions, including the effective date and, in the case of partial termination, the portion to be terminated.

(3) By the recipient upon sending to HUD written notification setting forth the reasons for such termination, the effective date, and, in the case of partial termination, the portion to be terminated. However, if HUD determines in the case of partial termination that the reduced or modified portion of the grant will not accomplish the purposes for which the grant was made, it may terminate the grant in its entirety under either paragraphs (a)(1) or (a)(2) of this section.

(b) If costs are allowed under an award, the responsibilities of the recipient referred to in Sec. 84.71(a), including those for property management as applicable, shall be considered in the termination of the award, and provision shall be made for continuing responsibilities of the recipient after termination, as appropriate.

**Sec. 84.62  Enforcement.**

(a) Remedies for noncompliance. If a recipient materially fails to comply with the terms and conditions of an award, whether stated in a Federal statute, regulation, assurance, application, or notice of award, HUD may, in addition to imposing any of the special conditions outlined in Sec. 84.14, take one or more of the following actions, as appropriate in the circumstances.

(1) Temporarily withhold cash payments pending correction of the deficiency by the recipient or more severe enforcement action by HUD.

(2) Disallow (that is, deny both use of funds and any applicable matching credit for) all or part of the cost of the activity or action not in compliance.

(3) Wholly or partly suspend or terminate the current award.

(4) Withhold further awards for the project or program.

(5) Take other remedies that may be legally available.

(b) Hearings and appeals. In taking an enforcement action, HUD shall provide the recipient an opportunity for hearing, appeal, or other administrative proceeding to which the recipient is entitled under any statute or regulation applicable to the action involved.

(c) Effects of suspension and termination. Costs of a recipient resulting from obligations incurred by the recipient during a suspension or after termination of an award are not allowable unless HUD expressly authorizes them in the notice of suspension or termination or subsequently. Other recipient costs during suspension or after termination which are necessary and not reasonably avoidable are allowable if paragraphs (c)(1) and (c)(2) of this section apply.

(1) The costs result from obligations which were properly incurred by the recipient before the effective date of suspension or termination, are not in anticipation of it, and in the case of a termination, are noncancellable.

(2) The costs would be allowable if the award were not suspended or expired normally at the end of the funding period in which the termination takes effect.

(d) Relationship to debarment and suspension. The enforcement remedies identified in this section, including suspension and termination, do not preclude a recipient from being subject to debarment and suspension under E.O.s 12549 and 12689 and HUD’s implementing regulations at 24 CFR part 24 (see Sec. 84.13).
Subpart D--After-the-Award Requirements

Sec. 84.70 Purpose.

Sections 84.71 through 84.73 contain closeout procedures and other procedures for subsequent disallowances and adjustments.

Sec. 84.71 Closeout procedures.

(a) Recipients shall submit, within 90 calendar days after the date of completion of the award, all financial, performance, and other reports as required by the terms and conditions of the award. HUD may approve extensions when requested by the recipient.

(b) Unless HUD authorizes an extension, a recipient shall liquidate all obligations incurred under the award not later than 90 calendar days after the funding period or the date of completion as specified in the terms and conditions of the award or in HUD instructions.

(c) HUD shall make prompt payments to a recipient for allowable reimbursable costs under the award being closed out.

(d) The recipient shall promptly refund any balances of unobligated cash that HUD has advanced or paid and that is not authorized to be retained by the recipient for use in other projects. OMB Circular A-129 governs unreturned amounts that become delinquent debts.

(e) When authorized by the terms and conditions of the award, HUD shall make a settlement for any upward or downward adjustments to the Federal share of costs after closeout reports are received.

(f) The recipient shall account for any real and personal property acquired with Federal funds or received from the Federal Government in accordance with Secs. 84.31 through 84.37.

(g) In the event a final audit has not been performed prior to the closeout of an award, HUD shall retain the right to recover an appropriate amount after fully considering the recommendations on disallowed costs resulting from the final audit.

Sec. 84.72 Subsequent adjustments and continuing responsibilities.

(a) The closeout of an award does not affect any of the following.

(1) The right of HUD to disallow costs and recover funds on the basis of a later audit or other review.

(2) The obligation of the recipient to return any funds due as a result of later refunds, corrections, or other transactions.

(3) Audit requirements in Sec. 84.26.

(4) Property management requirements in Secs. 84.31 through 84.37.

(5) Records retention as required in Sec. 84.53.

(b) After closeout of an award, a relationship created under an award may be modified or ended in whole or in part with the consent of HUD and the recipient, provided the responsibilities of the recipient referred to in Sec. 84.73(a), including those for property management as applicable, are considered and provisions made for continuing responsibilities of the recipient, as appropriate.

Sec. 84.73 Collection of amounts due.

(a) Any funds paid to a recipient in excess of the amount to which the recipient is finally determined to be entitled under the terms and conditions of the award constitute a debt to the Federal Government. If not paid within a reasonable period after the demand for payment, HUD may reduce the debt by paragraphs (a)(1), (a)(2) or (a)(3) of this section.

(1) Making an administrative offset against other requests for reimbursements.

(2) Withholding advance payments otherwise due to the recipient.

(3) Taking other action permitted by statute.
(b) Except as otherwise provided by law, HUD shall charge interest on an overdue debt in accordance with 4 CFR Chapter II, "Federal Claims Collection Standards."

Subpart E--Use of Lump Sum Grants

Sec. 84.80 Conditions for use of Lump Sum (fixed price or fixed amount) grants.

(a) Heads of awarding activities (HAAs) shall determine and publish the funding arrangement for award programs having a published program regulation or Notice of Funding Availability. For other awards, discretion may be provided to Grant Officers to determine the funding arrangement on a transaction basis. In such cases, Grant Officers shall document the basis for selection of the funding arrangement in the negotiation record. Appropriate consideration to fixed amount (lump sum) awards shall be made if one or more of the following conditions are present:

(1) The HUD funding amount is definitely less than the total actual cost of the project.

(2) The HUD funding amount does not exceed $100,000 or the small purchase threshold fixed at 41 U.S.C. 403 (11), whichever is greater.

(3) The project scope is very specific and adequate cost, historical, or unit pricing data is available to establish a fixed amount award with assurance that the recipient will realize no increment above actual cost.

(b) [Reserved]

Sec. 84.81 Definition.

(a) A lump sum award is an award for a predetermined amount, as set forth in the grant agreement, which amount does not vary with the amount of the recipient's actual incurred costs. Under this type of award, HUD does not pay the recipient for its incurred costs but rather for completing certain defined events in the work or achievement of some other well-defined milestone. Some of the ways in which the grant amount may be paid are, but are not limited to:

(1) In several partial payments, the amount of each agreed upon in advance, and the "milestone" or event triggering the payment also agreed upon in advance, and set forth in the grant;

(2) On a unit price basis, for a defined unit or units (such as a housing counseling unit), at a defined price or prices, agreed to in advance of performance of the grant and set forth in the grant; or,

(3) In one payment at grant completion.

(b) The key distinction between a lump sum and a cost reimbursement grant is the lack of a direct relationship between the costs incurred by the recipient and the amount paid by HUD in the lump sum arrangement.

Sec. 84.82 Provisions applicable only to lump sum grants.

In addition to the provisions of this subpart E, subparts A and B of this part apply to lump sum grants.

(a) Financial and program management. Paragraphs (b) through (e) of this section prescribe standards for financial management systems, methods for making payments, budget revision approvals, and making audits.

(b) Standards for financial management systems. (1) Records that identify adequately the source and application of funds for federally-sponsored activities are required. These records shall contain information pertaining to Federal awards, authorizations, obligations, unobligated balances, assets, outlays, income and interest.

(2) Effective control over and accountability for all funds, property and other assets are required. Recipients shall adequately safeguard all such assets and assure they are used solely for authorized purposes.

(3) Comparison of outlays with budget amounts for each award is required. Whenever appropriate, financial information should be related to performance and unit cost data.

(4) Where HUD guarantees or insures the repayment of money borrowed by the recipient, HUD, at its discretion, may require adequate bonding and insurance if the bonding and insurance requirements of the recipient are not deemed adequate to protect the interest of the Federal Government.

(5) HUD may require adequate fidelity bond coverage where the recipient lacks sufficient coverage to protect the Federal Government's interest.
(6) Where bonds are required in the situations described above, the bonds shall be obtained from companies holding certificates of authority as acceptable sureties, as prescribed in 31 CFR part 223, "Surety Companies Doing Business with the United States."

(c) Payment. (1) The standard governing the use of banks and other institutions as depositories of funds advanced under awards is, HUD shall not require separate depository accounts for funds provided to a recipient or establish any eligibility requirements for depositories for funds provided to a recipient. However, recipients must be able to account for the receipt, obligation and expenditure of funds.

(2) Consistent with the national goal of expanding the opportunities for women-owned and minority-owned business enterprises, recipients shall be encouraged to use women-owned and minority-owned banks (a bank which is owned at least 50 percent by women or minority group members).

(3) Except as noted elsewhere in this part, only the following forms shall be authorized for the recipients in requesting payments. HUD shall not require more than an original and two copies of these forms.

(i) SF-270, Request for Advance or Reimbursement. HUD has adopted the SF-270 as a standard form for all nonconstruction programs when electronic funds transfer or predetermined advance methods are not used. The SF-270 shall also be used for lump sum payment requests. HUD, however, has the option of using this form for construction programs in lieu of the SF-271, "Outlay Report and Request for Reimbursement for Construction Programs."

(ii) SF-271, Outlay Report and Request for Reimbursement for Construction Programs. HUD has adopted the SF-271 as the standard form to be used for requesting reimbursement for construction programs. However, HUD may substitute the SF-270 when HUD determines that it provides adequate information to meet HUD’s needs.

(d) Revision of budget and program plans. (1) The budget plan is the financial expression of the project or program as approved during the award process. It may include either the Federal and non-Federal share, or only the Federal share, depending upon HUD requirements. It shall be related to performance for program evaluation purposes whenever appropriate.

(2) Recipients are required to report deviations from program plans, and request prior approvals for budget and program plan revisions, in accordance with this section.

(3) For nonconstruction awards, recipients shall request prior approvals from HUD for one or more of the following program or budget related reasons.

(i) Change in the scope or the objective of the project or program (even if there is no associated budget revision requiring prior written approval).

(ii) The need for additional Federal funding.

(iii) Unless described in the application and funded in the approved awards, the subaward, transfer or contracting out of any work under an award. This provision does not apply to the purchase of supplies, material, equipment or general support services.

(4) No other prior approval requirements for specific items may be imposed unless a deviation has been approved by OMB.

(5) Except for requirements listed in paragraphs (d)(3)(i) and (d)(3)(ii) of this section, HUD is authorized, at its option, to waive cost-related and administrative prior written approvals required by Circular A-110 and OMB Circulars A-21 and A-122. Such waivers may include authorizing recipients to do any one or more of the following.

(i) Initiate a one-time extension of the expiration date of the award of up to 12 months unless one or more of the following conditions apply. For one-time extensions, the recipient must notify HUD in writing with the supporting reasons and revised expiration date at least 10 days before the expiration date specified in the award. This action may be taken unless:

(A) The terms and conditions of award prohibit the extension.

(B) The extension requires additional Federal funds.

(C) The extension involves any change in the approved objectives or scope of the project.

(6) For construction awards, recipients shall request prior written approval promptly from HUD for budget revisions whenever paragraphs (d)(6)(i) or (d)(6)(ii) of this section apply.

(i) The revision results from changes in the scope or the objective of the project or program.
(ii) The need arises for additional Federal funds to complete the project.

(7) No other prior approval requirements for specific items may be imposed unless a deviation has been approved by OMB.

(8) When HUD makes an award that provides support for both construction and nonconstruction work, HUD may require the recipient to request prior approval from HUD before making any fund or budget transfers between the two types of work supported.

(e) Non-Federal audits. (1) Recipients and subrecipients that are institutions of higher education or other non-profit organizations (including hospitals) shall be subject to the audit requirements contained in the Single Audit Act Amendments of 1996 (31 U.S.C. 7501-7507) and revised OMB Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations."

(ii) Non-profit organizations subject to regulations in the part 200 and part 800 series of this title which receive awards subject to part 84 shall comply with the audit requirements of revised OMB Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations." For HUD programs, a non-profit organization is the mortgagor or owner (as these terms are defined in the regulations in the part 200 and part 800 series) and not a related or affiliated organization or entity.

(ii) [Reserved]

(2) State and local governments shall be subject to the audit requirements contained in the Single Audit Act Amendments of 1996 (31 U.S.C. 7501-7507) and revised OMB Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations."

(3) For-profit hospitals not covered by the audit provisions of revised OMB Circular A-133 shall be subject to the audit requirements of the Federal awarding agencies.

(4) Commercial organizations shall be subject to the audit requirements of HUD or the prime recipient as incorporated into the award document.


Sec. 84.83 Property standards.

(a) Purpose of property standards. Paragraphs (b) through (g) of this section set forth uniform standards governing management and disposition of property furnished by the Federal Government whose cost was charged to a project supported by a Federal award. HUD shall require recipients to observe these standards under awards and shall not impose additional requirements, unless specifically required by Federal statute. The recipient may use its own property management standards and procedures provided it observes the provisions of paragraphs (b) through (g) of this section.

(b) Insurance coverage. Recipients shall, at a minimum, provide the equivalent insurance coverage for real property and equipment acquired with Federal funds as provided to property owned by the recipient. Federally-owned property need not be insured unless required by the terms and conditions of the award.

(c) Real property. HUD prescribes the following requirements for recipients concerning the use and disposition of real property acquired in whole or in part under awards:

(1) Title to real property shall vest in the recipient subject to the condition that the recipient shall use the real property for the authorized purpose of the project as long as it is needed and shall not encumber the property without approval of HUD.

(2) The recipient shall obtain written approval by HUD for the use of real property in other federally-sponsored projects when the recipient determines that the property is no longer needed for the purpose of the original project. Use in other projects shall be limited to those under federally-sponsored projects (i.e., awards) or programs that have purposes consistent with those authorized for support by HUD.

(d) Federally-owned and exempt property--(1) Federally-owned property--(i) Title to federally-owned property remains vested in the Federal Government. Recipients shall submit annually an inventory listing of federally-owned property in their custody to HUD. Upon completion of the award or when the property is no longer needed, the recipient shall report the property to HUD for further HUD utilization.

(ii) If HUD has no further need for the property, it shall be declared excess and reported to the General Services Administration, unless HUD has statutory authority to dispose of the property by alternative methods (e.g., the
authority provided by the Federal Technology Transfer Act (15 U.S.C. 3710 (I)) to donate research equipment to educational and non-profit organizations in accordance with E.O. 12821, "Improving Mathematics and Science Education in Support of the National Education Goals.") Appropriate instructions shall be issued to the recipient by HUD.

(2) Exempt property. When statutory authority exists, HUD has the option to vest title to property acquired with Federal funds in the recipient without further obligation to the Federal Government and under conditions HUD considers appropriate. Such property is "exempt property.") Should HUD not establish conditions, title to exempt property upon acquisition shall vest in the recipient without further obligation to the Federal Government.

(e) Equipment. (1) Title to equipment acquired by a recipient with Federal funds shall vest in the recipient, subject to conditions of this section.

(2) The recipient shall use the equipment in the project or program for which it was acquired as long as needed, whether or not the project or program continues to be supported by Federal funds and shall not encumber the equipment without approval of HUD. When the equipment is no longer needed for the original project or program, the recipient shall use the equipment in connection with its other federally-sponsored activities, in the following order of priority:

(i) Activities sponsored by HUD which funded the original project; then

(ii) Activities sponsored by other Federal awarding agencies.

(3) During the time that equipment is used on the project or program for which it was acquired, the recipient shall make it available for use on other projects or programs if such other use will not interfere with the work on the project or program for which the equipment was originally acquired. First preference for such other use shall be given to other projects or programs sponsored by HUD that financed the equipment; second preference shall be given to projects or programs sponsored by other Federal awarding agencies. If the equipment is owned by the Federal Government, use on other activities not sponsored by the Federal Government shall be permissible if authorized by HUD.

(4) The recipient's property management standards for equipment acquired with Federal funds and federally-owned equipment shall include all of the following.

(i) Equipment records shall be maintained accurately and shall include the following information.

(A) A description of the equipment.

(B) Manufacturer's serial number, model number, Federal stock number, national stock number, or other identification number.

(C) Source of the equipment, including the award number.

(D) Whether title vests in the recipient or the Federal Government.

(E) Acquisition date (or date received, if the equipment was furnished by the Federal Government) and cost.

(F) Location and condition of the equipment and the date the information was reported.

(ii) Equipment owned by the Federal Government shall be identified to indicate Federal ownership.

(iii) A physical inventory of equipment shall be taken and the results reconciled with the equipment records at least once every two years. Any differences between quantities determined by the physical inspection and those shown in the accounting records shall be investigated to determine the causes of the difference. The recipient shall, in connection with the inventory, verify the existence, current utilization, and continued need for the equipment.

(iv) A control system shall be in effect to insure adequate safeguards to prevent loss, damage, or theft of the equipment. Any loss, damage, or theft of equipment shall be investigated and fully documented; if the equipment was owned by the Federal Government, the recipient shall promptly notify HUD.

(v) Adequate maintenance procedures shall be implemented to keep the equipment in good condition.

(5) HUD may reserve the right to transfer the title to the Federal Government or to a third party named by the Federal Government when such third party is otherwise eligible under existing statutes. Such transfer shall be subject to the following standards.

(i) The equipment shall be appropriately identified in the award or otherwise made known to the recipient in writing.
(ii) HUD shall issue disposition instructions within 120 calendar days after receipt of a final inventory. The final inventory shall list all equipment acquired with grant funds and federally-owned equipment. If HUD fails to issue disposition instructions within the 120 calendar day period, the recipient shall apply the standards of this section, as appropriate.

(iii) When HUD exercises its right to take title, the equipment shall be subject to the provisions for federally-owned equipment.

(f) Intangible property. (1) The recipient may copyright any work that is subject to copyright and was developed, or for which ownership was purchased, under an award. HUD reserves a royalty-free, nonexclusive and irrevocable right to reproduce, publish, or otherwise use the work for Federal purposes, and to authorize others to do so.

(2) Recipients are subject to applicable regulations governing patents and inventions, including government-wide regulations issued by the Department of Commerce at 37 CFR part 401, “Rights to Inventions Made by Nonprofit Organizations and Small Business Firms Under Government Grants, Contracts and Cooperative Agreements.”

(3) Unless waived by HUD, the Federal Government has the right to paragraphs (f)(3)(i) and (f)(3)(ii) of this section.

(i) Obtain, reproduce, publish or otherwise use the data first produced under an award.

(ii) Authorize others to receive, reproduce, publish, or otherwise use such data for Federal purposes.

(4) Title to intangible property and debt instruments acquired under an award or subaward vests upon acquisition in the recipient. The recipient shall use that property for the originally-authorized purpose.

(g) Property trust relationship. Real property, equipment, intangible property and debt instruments that are acquired or improved with Federal funds shall be held in trust by the recipient as trustee for the beneficiaries of the project or program under which the property was acquired or improved. HUD may require recipients to record liens or other appropriate notices of record to indicate that personal or real property has been acquired or improved with Federal funds and that use and disposition conditions apply to the property.

Sec. 84.84 Procurement standards.

(a) Purpose of procurement standards. Paragraphs (b) through (i) of this section set forth standards for use by recipients in establishing procedures for the procurement of supplies and other expendable property, equipment, real property and other services with Federal funds. These standards are furnished to ensure that such materials and services are obtained in an effective manner and in compliance with the provisions of applicable Federal statutes and executive orders. No additional procurement standards or requirements shall be imposed by HUD upon recipients, unless specifically required by Federal statute or executive order or approved by OMB.

(b) Recipient responsibilities. The standards contained in this section do not relieve the recipient of the contractual responsibilities arising under its contract(s). The recipient is the responsible authority, without recourse to HUD, regarding the settlement and satisfaction of all contractual and administrative issues arising out of procurements entered into in support of an award or other agreement. This includes disputes, claims, protests of award, source evaluation or other matters of a contractual nature. Matters concerning violation of statute are to be referred to such Federal, State or local authority as may have proper jurisdiction.

(c) Codes of conduct. The recipient shall maintain written standards of conduct governing the performance of its employees engaged in the award and administration of contracts. No employee, officer, or agent shall participate in the selection, award, or administration of a contract supported by Federal funds if a real or apparent conflict of interest would be involved. Such a conflict would arise when the employee, officer, or agent, any member of his or her immediate family, his or her partner, or an organization which employs or is about to employ any of the parties indicated herein, has a financial or other interest in the firm selected for an award. The officers, employees, and agents of the recipient shall neither solicit nor accept gratuities, favors, or anything of monetary value from contractors, or parties to subagreements. However, recipients may set standards for situations in which the financial interest is not substantial or the gift is an unsolicited item of nominal value. The standards of conduct shall provide for disciplinary actions to be applied for violations of such standards by officers, employees, or agents of the recipient.

(d) Competition. All procurement transactions shall be conducted in a manner to provide, to the maximum extent practical, open and free competition. The recipient shall be alert to organizational conflicts of interest as well as noncompetitive practices among contractors that may restrict or eliminate competition or otherwise restrain
trade. In order to ensure objective contractor performance and eliminate unfair competitive advantage, contractors that develop or draft specifications, requirements, statements of work, invitations for bids and/or requests for proposals shall be excluded from competing for such procurements.

Awards shall be made to the bidder or offeror whose bid or offer is responsive to the solicitation and is most advantageous to the recipient, price, quality and other factors considered. The other factors shall include the bidder's or offeror's compliance with Section 3 of the Housing and Urban Development Act of 1968 (12 U.S.C. 1701u), hereafter referred to as "Section 3." Section 3 provides that, to the greatest extent feasible, and consistent with existing Federal, State, and local laws, and regulations, economic opportunities generated by certain HUD financial assistance shall be directed to low- and very low-income persons. Solicitations shall clearly set forth all requirements that the bidder or offeror shall fulfill in order for the bid or offer to be evaluated by the recipient. Any and all bids or offers may be rejected when it is in the recipient's interest to do so.

(e) Procurement procedures. (1) All recipients shall establish written procurement procedures. These procedures shall provide for, at a minimum, that paragraphs (e)(1)(i), (e)(1)(ii) and (e)(1)(iii) of this section apply.

   (i) Recipients avoid purchasing unnecessary items.

   (ii) Where appropriate, an analysis is made of lease and purchase alternatives to determine which would be the most economical and practical procurement for the recipient.

   (iii) Solicitations for goods and services provide for all of the following.

      (A) A clear and accurate description of the technical requirements for the material, product or service to be procured. In competitive procurements, such a description shall not contain features which unduly restrict competition.

      (B) Requirements which the bidder/offeror must fulfill and all other factors to be used in evaluating bids or proposals.

      (C) A description, whenever practicable, of technical requirements in terms of functions to be performed or performance required, including the range of acceptable characteristics or minimum acceptable standards.

      (D) The specific features of "brand name or equal" descriptions that bidders are required to meet when such items are included in the solicitation.

      (E) The acceptance, to the extent practicable and economically feasible, of products and services dimensioned in the metric system of measurement.

      (F) Preference, to the extent practicable and economically feasible, for products and services that conserve natural resources and protect the environment and are energy efficient.

   (2) Positive efforts shall be made by recipients to utilize small businesses, minority-owned firms, and women's business enterprises, whenever possible. Recipients of Federal awards shall take all of the following steps to further this goal.

      (i) Ensure that small businesses, minority-owned firms, and women's business enterprises are used to the fullest extent practicable.

      (ii) Make information on forthcoming opportunities available and arrange time frames for purchases and contracts to encourage and facilitate participation by small businesses, minority-owned firms, and women's business enterprises.

      (iii) Consider in the contract process whether firms competing for larger contracts intend to subcontract with small businesses, minority-owned firms, and women's business enterprises.

      (iv) Encourage contracting with consortiums of small businesses, minority-owned firms and women's business enterprises when a contract is too large for one of these firms to handle individually.

      (v) Use the services and assistance, as appropriate, of such organizations as the Small Business Administration and the Department of Commerce's Minority Business Development Agency in the solicitation and utilization of small businesses, minority-owned firms and women's business enterprises.

   (3) The type of procuring instruments used (e.g., fixed price contracts, cost reimbursable contracts, purchase orders, and incentive contracts) shall be determined by the recipient but shall be appropriate for the particular procurement and for promoting the best interest of the program or project involved. The "cost-plus-a-percentage-of-cost" or "percentage of construction cost" methods of contracting shall not be used.

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(4) Contracts shall be made only with responsible contractors who possess the potential ability to perform successfully under the terms and conditions of the proposed procurement. Consideration shall be given to such matters as contractor integrity; compliance with public policy, including, where applicable, Section 3 of the Housing and Urban Development Act of 1968 (12 U.S.C. 1701u); record of past performance; financial and technical resources or accessibility to other necessary resources. In certain circumstances, contracts with certain parties are restricted by agencies' implementation of E.O.'s 12549 and 12689, "Debarment and Suspension," as set forth at 24 CFR part 24.

(5) Recipients shall, on request, make available for the Federal awarding agency, pre-award review and procurement documents, such as requests for proposals or invitations for bids, independent cost estimates, etc., when any of the following conditions apply.

(i) A recipient's procurement procedures or operation fails to comply with the procurement standards in HUD's implementation of Circular A-110.

(ii) The procurement is expected to exceed $100,000 or the small purchase threshold fixed at 41 U.S.C. 403 (11), whichever is greater, and is to be awarded without competition or only one bid or offer is received in response to a solicitation.

(iii) The procurement, which is expected to exceed the small purchase threshold, specifies a "brand name" product.

(iv) The proposed award over the small purchase threshold is to be awarded to other than the apparent low bidder under a sealed bid procurement.

(v) A proposed contract modification changes the scope of a contract or increases the contract amount by more than the amount of the small purchase threshold.

(f) Cost and price analysis. Some form of cost or price analysis shall be made and documented in the procurement files in connection with every procurement action. Price analysis may be accomplished in various ways, including the comparison of price quotations submitted, market prices and similar indicia, together with discounts. Cost analysis is the review and evaluation of each element of cost to determine reasonableness, allocability and allowability.

(g) Procurement records. Procurement records and files for purchases in excess of the small purchase threshold shall include the following at a minimum:

(1) Basis for contractor selection;

(2) Justification for lack of competition when competitive bids or offers are not obtained; and

(3) Basis for award cost or price.

(h) Contract administration. A system for contract administration shall be maintained to ensure contractor conformance with the terms, conditions and specifications of the contract and to ensure adequate and timely follow up of all purchases. Recipients shall evaluate contractor performance and document, as appropriate, whether contractors have met the terms, conditions and specifications of the contract.

(i) Contract provisions. The recipient shall include, in addition to provisions to define a sound and complete agreement, the following provisions in all contracts. The following provisions shall also be applied to subcontracts.

(1) Contracts in excess of the small purchase threshold shall contain contractual provisions or conditions that allow for administrative, contractual, or legal remedies in instances in which a contractor violates or breaches the contract terms, and provide for such remedial actions as may be appropriate.

(2) All contracts in excess of the small purchase threshold shall contain suitable provisions for termination by the recipient, including the manner by which termination shall be effected and the basis for settlement. In addition, such contracts shall describe conditions under which the contract may be terminated for default as well as conditions where the contract may be terminated because of circumstances beyond the control of the contractor.

(3) Except as otherwise required by statute, an award that requires the contracting (or subcontracting) for construction or facility improvements shall provide for the recipient to follow its own requirements relating to bid guarantees, performance bonds, and payment bonds unless the construction contract or subcontract exceeds $100,000. For those contracts or subcontracts exceeding $100,000, HUD may accept the bonding policy and requirements of the recipient, provided HUD has made a determination that the Federal Government's interest is adequately protected. If such a determination has not been made, the minimum requirements shall be as follows:
(i) A bid guarantee from each bidder equivalent to five percent of the bid price. The “bid guarantee” shall consist of a firm commitment such as a bid bond, certified check, or other negotiable instrument accompanying a bid as assurance that the bidder shall, upon acceptance of his bid, execute such contractual documents as may be required within the time specified.

(ii) A performance bond on the part of the contractor for 100 percent of the contract price. A “performance bond” is one executed in connection with a contract to secure fulfillment of all the contractor’s obligations under such contract.

(iii) A payment bond on the part of the contractor for 100 percent of the contract price. A “payment bond” is one executed in connection with a contract to assure payment as required by statute of all persons supplying labor and material in the execution of the work provided for in the contract.

(iv) Where bonds are required in the situations described herein, the bonds shall be obtained from companies holding certificates of authority as acceptable sureties pursuant to 31 CFR part 223, “Surety Companies Doing Business with the United States.”

(4) All negotiated contracts (except those for less than the small purchase threshold) awarded by recipients shall include a provision to the effect that the recipient, HUD, the Comptroller General of the United States, or any of their duly authorized representatives, shall have access to any books, documents, papers and records of the contractor which are directly pertinent to a specific program for the purpose of making audits, examinations, excerpts and transcriptions.

(5) All contracts, including small purchases, awarded by recipients and their contractors shall contain the procurement provisions of Appendix A to this rule, as applicable.

Sec. 84.85 Reports and records.

(a) Purpose of reports and records. Paragraphs (b) and (c) of this section set forth the procedures for monitoring and reporting on the recipient's financial and program performance and the necessary standard reporting forms. They also set forth record retention requirements.

(b) Monitoring and reporting program performance. (1) Recipients are responsible for managing and monitoring each project, program, subaward, function or activity supported by the award. Recipients shall monitor subawards to ensure subrecipients have met the audit requirements as delineated in Sec. 84.82(e).

(2) The Federal awarding agency shall prescribe the frequency with which the performance reports shall be submitted. Except as provided in paragraph (b)(6) of this section, performance reports shall not be required more frequently than quarterly or less frequently than annually. Annual reports shall be due 90 calendar days after the grant year; quarterly or semi-annual reports shall be due 30 days after the reporting period. The Federal awarding agency may require annual reports before the anniversary dates of multiple year awards in lieu of these requirements. The final performance reports are due 90 calendar days after the expiration or termination of the award.

(3) If inappropriate, a final technical or performance report shall not be required after completion of the project.

(4) When required, performance reports shall generally contain, for each award, brief information on each of the following:

(i) A comparison of actual accomplishments with the goals and objectives established for the period, the findings of the investigator, or both. Whenever appropriate and the output of programs or projects can be readily quantified, such quantitative data should be related to cost data for computation of unit costs.

(ii) Reasons why established goals were not met, if appropriate.

(5) Recipients shall not be required to submit more than the original and two copies of performance reports.

(6) Recipients shall immediately notify HUD of developments that have a significant impact on the award-supported activities. Also, notification shall be given in the case of problems, delays, or adverse conditions which materially impair the ability to meet the objectives of the award. This notification shall include a statement of the action taken or contemplated, and any assistance needed to resolve the situation.

(7) HUD may make site visits, as needed.

(8) HUD shall comply with clearance requirements of 5 CFR part 1320 when requesting performance data from recipients.
(c) Retention and access requirements for records. (1) This paragraph (c) sets forth requirements for record retention and access to records for awards to recipients. Federal awarding agencies shall not impose any other record retention or access requirements upon recipients.

(2) Financial records, supporting documents, statistical records, and all other records pertinent to an award shall be retained for a period of three years from the date of submission of the final expenditure report or, for awards that are renewed quarterly or annually, from the date of the submission of the quarterly or annual financial report, as authorized by HUD. The only exceptions are the following.

(i) If any litigation, claim, or audit is started before the expiration of the 3-year period, the records shall be retained until all litigation, claims or audit findings involving the records have been resolved and final action taken.

(ii) Records for real property and equipment acquired with Federal funds shall be retained for 3 years after final disposition.

(iii) When records are transferred to or maintained by the Federal awarding agency, the 3-year retention requirement is not applicable to the recipient.

(3) Copies of original records may be substituted for the original records if authorized by HUD.

(4) HUD shall request transfer of certain records to its custody from recipients when it determines that the records possess long term retention value. However, in order to avoid duplicate recordkeeping, HUD may make arrangements for recipients to retain any records that are continuously needed for joint use.

(5) HUD, the Inspector General, Comptroller General of the United States, or any of their duly authorized representatives, have the right of timely and unrestricted access to any books, documents, papers, or other records of recipients that are pertinent to the awards, in order to make audits, examinations, excerpts, transcripts and copies of such documents. This right also includes timely and reasonable access to a recipient's personnel for the purpose of interview and discussion related to such documents. The rights of access in this paragraph (c)(5) are not limited to the required retention period, but shall last as long as records are retained.

(6) Unless required by statute, HUD shall not place restrictions on recipients that limit public access to the records of recipients that are pertinent to an award, except when HUD can demonstrate that such records shall be kept confidential and would have been exempted from disclosure pursuant to the Freedom of Information Act (5 U.S.C. 552) if the records had belonged to HUD.

Sec. 84.86 Termination and enforcement.

(a) Termination. (1) Awards may be terminated in whole or in part only if paragraphs (a)(1)(i), (a)(1)(ii), or (a)(1)(iii) of this section apply.

(i) By HUD, if a recipient materially fails to comply with the terms and conditions of an award.

(ii) By HUD with the consent of the recipient, in which case the two parties shall agree upon the termination conditions, including the effective date and, in the case of partial termination, the portion to be terminated.

(iii) By the recipient upon sending to HUD written notification setting forth the reasons for such termination, the effective date, and, in the case of partial termination, the portion to be terminated. However, if HUD determines in the case of partial termination that the reduced or modified portion of the grant will not accomplish the purposes for which the grant was made, it may terminate the grant in its entirety under either paragraphs (a)(1)(i) or (a)(1)(ii) of this section.

(2) If costs are allowed under an award, the responsibilities of the recipient referred to in Sec. 84.87(a)(1), including those for property management as applicable, shall be considered in the termination of the award, and provision shall be made for continuing responsibilities of the recipient after termination, as appropriate.

(3) If costs are allowed, the cost principles in Sec. 84.27 apply, even though the award was made on a lump-sum basis. Alternatively, a termination settlement may be reached by prorating the grant amount against the percentage of completion or by some other method as determined by the Grant Officer, as long as the method used results in an equitable settlement to both parties.

(b) Enforcement. (1) Remedies for noncompliance. If a recipient materially fails to comply with the terms and conditions of an award, whether stated in a Federal statute, regulation, assurance, application, or notice of award, HUD may, in addition to imposing any of the special conditions outlined in Sec. 84.14, take one or more of the following actions, as appropriate in the circumstances.
(i) Temporarily withhold cash payments pending correction of the deficiency by the recipient or more severe enforcement action by HUD.

(ii) Wholly or partly suspend or terminate the current award.

(iii) Withhold further awards for the project or program.

(iv) Take other remedies that may be legally available.

(2) Hearings and appeals. In taking an enforcement action, HUD shall provide the recipient an opportunity for hearing, appeal, or other administrative proceeding to which the recipient is entitled under any statute or regulation applicable to the action involved.

(3) Effects of suspension and termination. Costs of a recipient resulting from obligations incurred by the recipient during a suspension or after termination of an award are not allowable unless HUD expressly authorizes them in the notice of suspension or termination or subsequently. Other recipient costs during suspension or after termination which are necessary and not reasonably avoidable are allowable if paragraphs (b)(3)(i) and (b)(3)(ii) of this section apply.

(i) The costs result from obligations which were properly incurred by the recipient before the effective date of suspension or termination, are not in anticipation of it, and in the case of a termination, are noncancellable.

(ii) The costs would be allowable if the award were not suspended or expired normally at the end of the funding period in which the termination takes effect.

(4) Relationship to debarment and suspension. The enforcement remedies identified in this section, including suspension and termination, do not preclude a recipient from being subject to debarment and suspension under E.O.s 12549 and 12689 and HUD's implementing regulations at 24 CFR part 24 (see Sec. 84.13).

Sec. 84.87 Closeout procedures, subsequent adjustments and continuing responsibilities.

(a) Closeout procedures. (1) Recipients shall submit, within 90 calendar days after the date of completion of the award, all financial, performance, and other reports as required by the terms and conditions of the award. HUD may approve extensions when requested by the recipient.

(2) The recipient shall account for any real and personal property acquired with Federal funds or received from the Federal Government in accordance with Secs. 84.83(b) through (g).

(b) Subsequent adjustments and continuing responsibilities. (1) The closeout of an award does not affect any of the following:

(i) Audit requirements in Sec. 84.26.

(ii) Property management requirements in Secs. 84.83(b) through (g).

(iii) Records retention as required in Sec. 84.53.

(2) After closeout of an award, a relationship created under an award may be modified or ended in whole or in part with the consent of HUD and the recipient, provided the responsibilities of the recipient are considered and provisions made for continuing responsibilities of the recipient, as appropriate.
Appendix A to Part 84--Contract Provisions

All contracts, awarded by a recipient including small purchases, shall contain the following provisions as applicable:


2. Copeland "Anti-Kickback" Act (18 U.S.C. 874 and 40 U.S.C. 276c)--All contracts and subcontracts in excess of $2000 for construction or repair awarded by recipients and subrecipients shall include a provision for compliance with the Copeland "Anti-Kickback" Act (18 U.S.C. 874), as supplemented by Department of Labor regulations (29 CFR part 3, "Contractors and Subcontractors on Public Building or Public Work Financed in Whole or in Part by Loans or Grants from the United States"). The Act provides that each contractor or subrecipient shall be prohibited from inducing, by any means, any person employed in the construction, completion, or repair of public work, to give up any part of the compensation to which he is otherwise entitled. The recipient shall report all suspected or reported violations to HUD.

3. Davis-Bacon Act, as amended (40 U.S.C. 276a to a-7)--When required by Federal program legislation, all construction contracts awarded by the recipients and subrecipients of more than $2000 shall include a provision for compliance with the Davis-Bacon Act (40 U.S.C. 276a to a-7) and as supplemented by Department of Labor regulations (29 CFR part 5, "Labor Standards Provisions Applicable to Contracts Governing Federally Financed and Assisted Construction"). Under this Act, contractors shall be required to pay wages to laborers and mechanics at a rate not less than the minimum wages specified in a wage determination made by the Secretary of Labor. In addition, contractors shall be required to pay wages not less than once a week. The recipient shall place a copy of the current prevailing wage determination issued by the Department of Labor in each solicitation and the award of a contract shall be conditioned upon the acceptance of the wage determination. The recipient shall report all suspected or reported violations to HUD.

4. Contract Work Hours and Safety Standards Act (40 U.S.C. 327 through 333)--Where applicable, all contracts awarded by recipients in excess of $2000 for construction contracts and in excess of $2500 for other contracts that involve the employment of mechanics or laborers shall include a provision for compliance with Sections 102 and 107 of the Contract Work Hours and Safety Standards Act (40 U.S.C. 327-333), as supplemented by Department of Labor regulations (29 CFR part 5). Under Section 102 of the Act, each contractor shall be required to compute the wages of every mechanic and laborer on the basis of a standard workweek of 40 hours. Work in excess of the standard workweek is permissible provided that the worker is compensated at a rate of not less than 1 1/2 times the basic rate of pay for all hours worked in excess of 40 hours in the workweek. Section 107 of the Act is applicable to construction work and provides that no laborer or mechanic shall be required to work in surroundings or under working conditions which are unsanitary, hazardous or dangerous. These requirements do not apply to the purchases of supplies or materials or articles ordinarily available on the open market, or contracts for transportation or transmission of intelligence.

5. Rights to Inventions Made Under a Contract or Agreement--Contracts or agreements for the performance of experimental, developmental, or research work shall provide for the rights of the Federal Government and the recipient in any resulting invention in accordance with 37 CFR part 401, "Rights to Inventions Made by Nonprofit Organizations and Small Business Firms Under Government Grants, Contracts and Cooperative Agreements," and any implementing regulations issued by HUD.

6. Clean Air Act (42 U.S.C. 7401 et seq.) and the Federal Water Pollution Control Act (33 U.S.C. 1251 et seq.), as amended--Contracts and subcontracts of amounts in excess of $100,000 shall contain a provision that requires the recipient to agree to comply with all applicable standards, orders or regulations issued pursuant to the Clean Air Act (42 U.S.C. 7401 et seq.) and the Federal Water Pollution Control Act as amended (33 U.S.C. 1251 et seq.). Violations shall be reported to HUD and the Regional Office of the Environmental Protection Agency (EPA).

8. Debarment and Suspension (E.O.s 12549 and 12689)--No contract shall be made to parties listed on the General Services Administration’s List of Parties Excluded from Federal Procurement or Nonprocurement Programs in accordance with E.O.s 12549 and 12689, “Debarment and Suspension,” as set forth at 24 CFR part 24. This list contains the names of parties debarred, suspended, or otherwise excluded by agencies, and contractors declared ineligible under statutory or regulatory authority other than E.O. 12549. Contractors with awards that exceed the small purchase threshold shall provide the required certification regarding its exclusion status and that of its principal employees.

9. Drug-Free Workplace Requirements--The Drug-Free Workplace Act of 1988 (42 U.S.C. 701) requires grantees (including individuals) of federal agencies, as a prior condition of being awarded a grant, to certify that they will provide drug-free workplaces. Each potential recipient must certify that it will comply with drug-free workplace requirements in accordance with the Act and with HUD’s rules at 24 CFR part 24, subpart F.
OFFICE OF MANAGEMENT AND BUDGET

OMB Circular A-122
Cost Principles for Non-Profit Organizations

AGENCY: Office of Management and Budget

ACTION: Final revision of OMB Circular A-122, “Cost Principles for Non-Profit Organizations"

SUMMARY: The Office of Management and Budget (OMB) revises OMB Circular A-122 by amending the definition for equipment; requiring the breakout of indirect costs into two categories (facilities and administration) for certain non-profit organizations; modifying the multiple allocation basis; and, clarifying the treatment of certain cost items.

DATES: The revision is effective on June 1, 1998.

FOR FURTHER INFORMATION CONTACT: Federal agencies should contact Gilbert Tran, Office of Federal Financial Management, Office of Management and Budget, (202) 395-3993. Non-Federal organizations should contact the organization's Federal cognizant agency.

SUPPLEMENTARY INFORMATION:

A. Background
On October 6, 1995, the Office of Management and Budget (OMB) issued a final revision to OMB Circular A-122, "Cost Principles for Non-Profit Organizations," in the Federal Register (60 FR 52516) regarding interest allowability. The revision was made in a continuing effort to increase consistency across OMB's cost principles circulars A-122, A-21, "Cost Principles for Educational Institutions," and A-87, "Cost Principles for State, Local and Indian Tribal Governments." To further the goals of consistency, OMB proposed on the same date (60 FR 52522) to revise the definition of equipment, to clarify the treatment of certain types of costs, to modify the multiple allocation base method for computing indirect cost rate(s), and to place an upper-limit on payments of administrative expenses for certain non-profit organizations.

With this final revision, Circular A-122 consists of the Circular as issued in 1980 (45 FR 46022; July 8, 1980), as amended in 1984 (49 FR 18260; April 27, 1984), in 1987 (52 FR 19788; May 27, 1987), in 1995 (60 FR 52516; October 6, 1995), in 1997 (62 FR 45934; August 29, 1997), and in this notice. A recompilation of the entire Circular A-122, with all its amendments, accompanies the notice and is available in electronic form on the OMB Home Page at /OMB.

B. Current Revisions
Circular A-122 is revised in this notice to:

1. Amend the definition of equipment by increasing the capitalization threshold to the lesser amount used for financial statement purposes or $5,000 (see paragraph 15).

2. Require major non-profit organizations (those receiving more than $10 million in direct Federal funding) to report indirect cost rates by two major component categories: facilities and administration (see paragraph D, Attachment A).

3. Modify the multiple allocation base method (MAB) to be consistent with OMB Circular A-21 (see paragraph D.3). However, major non-profit organizations are not required to use the multiple allocation base method. MAB remains one of the three available methodologies for computing indirect costs.

4. Clarify the treatment of the following cost items to provide consistency across OMB's cost principles circulars (A-21 and A-87) and the Federal Acquisition Regulations, where applicable:

   Alcoholic beverages
   Advertising and public relations costs
Organization-furnished automobiles
Defense and prosecution of criminal and civil proceedings, claims, appeals and patent infringements
Housing and living expenses
Insurance
Memberships
Selling or marketing of goods and services
Severance pay for foreign nationals

OMB is not implementing the proposed restrictions on trustees' travel expenses at non-profit organizations. In line with this decision, and to further consistency between cost circulars, OMB will be amending Circular A-21 to allow trustees' travel expenses.

OMB defers considering an upper-limit on payment of administrative expenses until better data on indirect costs at non-profit organizations are collected.

C. Comments and Responses

OMB received about 185 comments from non-profit organizations, Federal agencies, professional organizations and accounting firms. A summary of comments and OMB's responses are included in this notice. Several comments resulted in modifications to OMB's original proposal.

The comments and OMB's responses are summarized by section as follow.

Equipment Definition

Comment: Clarification is needed on the treatment of depreciation of those assets which had costs between the old $500 threshold and the new $5,000.

Response: In order to clarify the accounting for the undepreciated portion of any equipment costs as a result of a change in capitalization levels, paragraph 15 has been added to explain that the undepreciated amount may be recovered by continuing to claim otherwise allowable use allowances or depreciation on the equipment, or by amortizing the amount to be written off over a period of years as negotiated with the Federal cognizant agency.

Comment: Clarification is needed on whether equipment under the $5,000 threshold, as established by the non-profit organizations' policy, requires Federal approval prior to acquisition.

Response: Equipment under the $5,000 threshold, as established by the non-profit organization's policy, can be directly charged to sponsored agreements (subparagraph 15.b) without prior Federal approval.

Comment: Current subparagraph 13.b requires prior approval for special purpose equipment, as direct costs, with a unit cost of $1,000 or more. This requirement is not consistent with the higher threshold of $5,000 allowed in the proposed revision. This requirement should be revised to be consistent with the proposed revision.

Response: OMB agrees. The Circular is revised to require prior Federal approval only for special purpose equipment with a unit cost of $5,000 or more.

Unallowable Cost Items

These ten revised cost items are already unallowable under OMB Circulars A-21, "Cost Principles for Educational Institutions," and A-87, "Cost Principles for State, Local and Indian Tribal Governments," and/or the Federal Acquisition Regulations. OMB addressed the issue of trustees' travel in response to the comments received. For the other items, consistency across Federal cost regulations was a more significant issue than most of the commenters' concerns. Comments related to specific cost items are presented below, followed by OMB's responses.

Advertising and Public Relations Costs

Comment: Current paragraph 37, Public information service costs, should be combined with the "Advertising" paragraph to be consistent with other OMB cost principles in Circulars A-21 and A-87.

Response: The commenter is correct. The treatment of public information service costs is now addressed in revised paragraph 1, Advertising and public relations costs. Current paragraph 37 is deleted.
Comment: Clarify the types of activities that are allowable as public relations costs. Public relations costs to carry out certain functions, such as legitimate program outreach, that are required under sponsored programs and contracts should be allowable.

Response: The Circular is revised to clarify that certain public relations costs for the purpose of communicating specific activities related to the sponsored programs to the public or the press are allowable costs. When they are necessary for program outreach effort as required by sponsored programs, public relations costs are allowable. Costs of advertising and public relations incurred solely to promote the organization are unallowable.

Comment: Clarify whether advertising media costs such as radio and television are allowable.

Response: As long as the public relations costs are specifically required by the sponsored programs or are related to the promotion of sponsored programs, any reasonable advertising media, including magazines, newspapers, radio, television, direct mail, exhibits, and the like, can be used and its costs are allowable. See paragraph 1.a.

Comment: Community relation costs should be allowable as part of program outreach effort for Federal sponsored programs.

Response: Community relations are defined in subparagraph 1.b as "those activities dedicated to maintain the image of the organization or promoting understanding and favorable relations with the community or public at large or any segment of the public." Costs related to community relations are allowable when the costs are required or necessary to the performance of the sponsored programs.

Organization-furnished automobiles for personal use

Comment: For security and economic reasons, non-profit organizations often furnish automobiles and housing for its personnel working on Federal projects (e.g., overseas projects sponsored by the U.S. Agency for International Development or the U.S. State Department). These costs should be allowable as direct costs.

Response: The Circular is revised to allow these costs when they are necessary to perform the Federal projects, particularly the overseas sponsored projects with prior approval by the Federal awarding agency. These costs are allowable only as direct costs to the Federal projects, and not as fringe benefit or indirect costs.

Comment: The Circular should specify which types of automobiles are allowable or unallowable (e.g., cars, vans, trucks and buses).

Response: The types of automobiles are irrelevant for the purpose of determining the allowability of automobile costs. Rather, the determinant factors should be whether the automobile costs are reasonable and necessary for the performance of the Federal projects and authorized by the Federal awarding agency.

Defense and prosecution of criminal and civil proceedings, claims, appeals and patent infringements

Comment: Current paragraph 35.d, Professional service costs, should be combined with new paragraph 10.

Response: OMB agrees. Current paragraph 35.d is deleted. Professional service costs related to defense of antitrust suits, prosecution of claims against the Federal Government and patent infringement litigation are discussed in new paragraph 10. Professional service costs incurred for organization and reorganization are discussed in paragraph 31, Organization costs.

Comment: Clarification is needed as to when legal costs related to claims, appeals or proceeding become unallowable. Commenters noted that Federal agencies are inconsistent in the determination of the allowability of legal costs as one agency would allow legal costs up to the point where the case goes out of the Federal agency appeal process and to the courts, whereas other agencies would only allow legal costs through the first phase of appeals within the Federal agency.

Response: The policy makes unallowable legal and related costs for either defending against claims made by the Federal Government or prosecuting claims against the Government. As such, once a final management decision letter is issued by the agency (for example, a disallowance letter), all legal and related costs are unallowable from that point forward. Unallowable costs would include claims and defenses pursued through agencies' formal appeal procedures such as administrative law judges and agency appeal boards. Note that legal and related costs may be
allowable if the non-profit organization's position is sustained by the administrative appeal process or an agreement
is reached between the organization and the Federal Government (see subparagraphs 10.b, 10.c, 10.d and 10.e).
This revision is consistent with the language contained in OMB Circular A-21, "Cost Principles for Educational
Institutions."

Comment: Some commenters objected to the proposed 80 percent limitation on reimbursement when the
institution is found innocent.

Response: The proposed revision was retained because it provides consistency with procurement contracts. This
limitation is based on the statutory language of Public Law 100-700, Major Fraud Act of 1988, November 19, 1988
(41 U.S.C., 256 (k)(5)), which only allows recovery of 80 percent of the legal costs.

Comment: Legal expenses to defend against lawsuits brought by a foreign government for violation of that
country's law should be allowable.

Response: The Circular is revised in subparagraph 10.d to authorize Federal agencies to allow legal expenses to
defend against lawsuits brought by a foreign government for violation of its law when such costs were necessary or
were direct results of the performance of Federal sponsored programs. The same authorizations apply for legal
costs for defense against lawsuits brought by state or local governments.

Comment: Legal fees to defend against lawsuits filed by former employees for termination or by subrecipients
should be allowable.

Response: Legal fees incurred in defense of lawsuits not brought by a Federal, State, local or foreign government,
except when the suits are brought by former employees under Section 2 of the Major Fraud Act of 1988 (Pub. L.
100-700), are allowable.

**Housing and living expenses**

Comment: For security and economic reasons, non-profit organizations often furnish automobiles and housing for
its personnel working on overseas Federal projects (e.g., overseas projects sponsored by the U.S. Agency for
International Development). These costs should be allowable as direct costs.

Response: As previously noted (in the discussion of automobiles), the Circular is revised to allow these costs when
they are necessary to perform the Federal projects and when they are approved by the Federal awarding agency.
These costs are allowable only as direct costs to the Federal projects, and not as fringe benefit or indirect costs.

**Insurance**

Comment: General and casualty liability insurance costs for organization's directors and administrators should be
allowable.

Response: General and casualty liability insurance costs for organization's directors and administrators are
allowable, subject to limitations, as described in subparagraph 22.a.(2). New subparagraph 22.a.(2).f, Insurance
against defects, prohibits the reimbursement of costs against Federally sponsored awards for product (or services)
liability insurance costs.

Comment: Medical liability insurance costs for participants in Federal training programs should be allowable.

Response: Medical liability insurance costs associated with participants in Federal training programs are allowable
to Federal programs as direct costs.

Comment: Malpractice insurance costs for physicians should be direct charged to Federal programs while
malpractice insurance costs for nurses or laboratory assistants, which are immaterial in most cases, should be
charged as indirect costs.

Response: Subparagraph B.2 of Attachment A provides that when a direct cost is of minor amounts, it may be
treated as an indirect cost for reasons of practicality and efficiency, provided that the accounting treatment for such
cost is consistently applied to all final cost objectives. Therefore, when malpractice insurance costs for nurses or lab
technicians are immaterial in relation to its effect on the overall indirect cost rates of the organization, they may be treated as indirect costs.

**Memberships**

Comment: Membership costs in civic and community organizations should be allowable.

Response: Membership costs are allowable for business and professional organizations. The Circular is further revised to allow membership costs in civic and community organizations when associations with these organizations are essential to the performance of the Federal programs (as an outreach function). These membership costs must be approved by the Federal cognizant agency.

Comment: Costs of membership in organizations that lobby should be unallowable.

Response: Paragraph 25 of the Circular disallows lobbying costs. Membership dues to lobbying organizations are therefore unallowable. The unallowable portion of membership dues is determined by the percentage of lobbying activities versus other allowable activities of the lobbying organization.

**Selling or Marketing of Goods and Services**

Comment: Clarification is needed for what types of activities are considered to be the selling or marketing of goods and services.

Response: Selling or marketing of goods and services generally include an organization's efforts to market the organization's products or services such as through advertising, organizational image enhancement, market planning and direct selling. Direct selling efforts are those acts or actions used to induce particular customers to purchase particular products or services of the organization. The allowability provisions for advertising costs are described in paragraph 1.

Comment: The guidelines for selling or marketing of goods and services should be consistent with those in FAR 31.205.38(c)(1).

Response: FAR 31.205.38(c)(1) allows direct selling costs at commercial contractors if they are reasonable in amount. By contrast to the commercial contract context, direct selling costs are generally not considered to be necessary costs for the performance of Federal sponsored programs by non-profit organizations. In those cases where they are essential for certain Federal sponsored programs, these costs can be charged as direct costs to the Federal sponsored programs if they are approved by the Federal awarding agency.

Comment: Given that the Bayh-Dole Act encouraged technology transfer, selling or marketing costs of goods or services should be allowable costs. At the minimum, these costs should be allowable as direct costs to the Federal projects.

Response: The Circular is revised to allow selling or marketing costs as direct costs to some Federal sponsored programs when approved by the Federal awarding agency.

**Severance Pay**

Comment: Early retirement benefits should be allowable costs.

Response: Early retirement benefit costs are allowable costs, subject to limitations, and are discussed in subparagraph 6.f, Fringe Benefits, along with other forms of fringe benefits. Paragraph 49, Severance Pay, deals only with severance policy, i.e., dismissal, and the reimbursement of its costs.

Comment: Guidelines for costs of severance pay to foreign nationals in excess of customary or prevailing practices should be consistent with section 2151 of the Federal Acquisition Streamlining Act of 1994 (FASA).

Response: OMB agrees. The Circular is revised to be consistent with FASA guidelines for severance pay to foreign nationals in excess of customary or prevailing practices. As a result, the Federal awarding agency may allow these costs when they are necessary for the performance of the Federal sponsored programs.
Trustees' Travel

Comment: Several commenters opposed the proposal to disallow trustees' travel costs citing the difficulty of retaining or obtaining members to serve voluntarily on the Board of Trustees (or Directors) of a non-profit organization, if Board members have to pay for their own travel expenses to attend Board meetings. The commenters added that since serving on a non-profit organization's Board is often not as prestigious and desirable as serving on a University's Board (where trustees' travel costs are unallowable under Circular A-21), non-reimbursement of the travel costs would inhibit the recruitment of Board members.

Response: OMB concurs that disallowing the reimbursement of trustees' travel costs could inhibit the recruitment of qualified Board members (particularly at smaller non-profit organizations), thereby hampering the operations of a non-profit organization. OMB also recognizes that trustees' travel costs are reasonable and necessary business costs. As a result, trustees' travel costs remain allowable.

Comment: Trustees' travel costs should be allowable if they are reasonable. Some suggested tests for reasonableness of trustees' travel costs are: limit number of allowed trips per year, restriction of trips to organization's principal place of business or reasonable surroundings, distinction between scheduled Board meetings and emergency Board meetings, and disallowance of first-class airfare travels.

Response: All costs charged to Federal projects must satisfy a reasonableness test. Although some of the suggested reasonableness tests appear to be good, OMB does not believe it is necessary at this time to impose specific restrictions on trustees' travel expenses. The reasonableness of a particular travel expense remains at the judgement of Federal negotiators.

Comment: At Head Start organizations, some Trustee members are first sent for training in the operations of a Head Start program. These travel costs related to training should be allowable.

Response: Travel costs related to training and education are allowable, subject to limitations, and are addressed in paragraph 53 of the Circular, Training and education costs.

Comment: At Head Start organizations, there often are several advisory boards in addition to the Board of Trustees (or Directors). These advisory boards are involved in day-to-day operations of the organizations and often incur travel costs. Are these costs subject to the same restrictions as trustees' travel?

Response: Travel costs for members of advisory groups are allowable, subject to the limitations in paragraph 55, Travel costs.

Multiple Allocation Basis (MAB)

Comment: The multiple allocation method for calculating indirect costs rates is much more complicated and burdensome than the simplified method and it will cost non-profit organizations much more to prepare the indirect cost proposal. Several commenters recommended the flexibility of using one of the three different allocation methods as they are currently described in the Circular. The multiple allocation basis (MAB) should remain an optional allocation methodology rather than a required methodology for certain organizations.

Response: The use of MAB for major non-profit organizations promotes consistency in the calculation and the reporting of indirect costs. It would facilitate the accumulation of indirect cost data by cost components (i.e., facilities and administration) and provide comparable rates between major research non-profit organizations and universities. However, OMB recognizes that a conversion to MAB may require some substantial changes in the organization's accounting system and that MAB is not practical for single-function organizations. Therefore, the Circular continues to allow non-profit organizations to use any of the current three allocation methodologies.

Comment: Several commenters suggested raising the threshold for the requirement to $25 million in direct Federal funding. Several commenters also suggested an exemption from this requirement for single-function organizations regardless of Federal funding levels.

Response: The Circular is revised to allow the use of the current three allocation methodologies for all non-profit organizations. For organizations that receive more than $10 million in direct Federal funding, a breakout of indirect costs into two components, facilities and administration, is required regardless of the selected allocation methodology.
Comment: The allocation methodology for general administration under MAB on the basis of modified total direct costs conflicts with the required methodology under Cost Accounting Standard (CAS) 410 applicable to contracts using the salaries and wages basis. One commenter suggested that a fully CAS-covered non-profit organization be exempted from the MAB requirement.

Response: MAB is not a requirement for non-profit organizations and remains one of the three available methodologies in the Circular for computing indirect costs. In addition, CAS-covered non-profit organizations should continue to follow CAS with respect to the measurement, assignment and allocation of costs.

Comment: The revision should clarify that the modified total direct cost base should only include the first $25,000 of a subcontract regardless of the period during which the project is started (consistent with OMB Circular A-21).

Response: The modified total direct cost base, described in subparagraph D.3.f of the Circular, includes the first $25,000 of each subgrant or subcontract regardless of the period covered by the subgrant or subcontract. Subgrant or subcontract costs above $25,000 shall be excluded from the modified total direct cost base. For example, for a $300,000 subgrant that lasts three years, only the first $25,000 incurred on the award should be included in the modified total direct cost base.

**Administrative Cap of 26 percent**

Comment: Most commenters strongly opposed the 26 percent administrative cap stating that such limitation on cost reimbursement is arbitrary, capricious, and unnecessary. Some argued that a cap would be financially disastrous to non-profit organizations because they receive most of their funding from Federal sources (unlike universities). A detailed analysis is urged to determine the average administrative costs applicable to non-profit organizations, if an administrative cap is to be implemented at non-profit organizations.

Response: Based on the comments against the implementation of an administrative cap at non-profit organizations, OMB defers the consideration of establishing any administrative cap until better data on indirect costs at non-profit organizations can be collected. If OMB believes that an administrative cap should be implemented, it would be proposed in a subsequent notice.

**Other**

Comment: Attachment C of the Circular should be updated since a few listed organizations no longer exist.

Response: OMB agrees. Attachment C is updated to delete those organizations that no longer exist or are no longer exempted from OMB Circular A-122.

Franklin D. Raines
Director

**Attachments A, B and C of Circular A-122 are revised as follows:**

**A. Attachment A**

1. Add subparagraph 3 to paragraph C ("Indirect Costs").

   3. Indirect costs shall be classified within two broad categories: "Facilities" and "Administration." "Facilities" is defined as depreciation and use allowances on buildings, equipment and capital improvement, interest on debt associated with certain buildings, equipment and capital improvements, and operations and maintenance expenses. "Administration" is defined as general administration and general expenses such as the director's office, accounting, personnel, library expenses and all other types of expenditures not listed specifically under one of the subcategories of "Facilities" (including cross allocations from other pools, where applicable). See indirect cost rate reporting requirements in subparagraphs D.2.e and D.3.g.

2. Add subparagraph 2.e to paragraph D.

   e. For an organization that receives more than $10 million in Federal funding of direct costs in a fiscal year, a breakout of the indirect cost component into two broad categories, Facilities and Administration as defined in subparagraph C.3, is required. The rate in each case shall be stated as the percentage which the amount of the
particular indirect cost category (i.e., Facilities or Administration) is of the distribution base identified with that
category.

3. Replace subparagraph D.3 with the following:

3. Multiple allocation base method.

a. General. Where an organization's indirect costs benefit its major functions in varying degrees, indirect costs
shall be accumulated into separate cost groupings, as described in subparagraph b. Each grouping shall then be
allocated individually to benefitting functions by means of a base which best measures the relative benefits. The
default allocation bases by cost pool are described in subparagraph c.

b. Identification of indirect costs. Cost groupings shall be established so as to permit the allocation of each
grouping on the basis of benefits provided to the major functions. Each grouping shall constitute a pool of
expenses that are of like character in terms of functions they benefit and in terms of the allocation base which best
measures the relative benefits provided to each function. The groupings are classified within the two broad
categories: "Facilities" and "Administration," as described in subparagraph C.3. The indirect cost pools are defined
as follows:

(1) Depreciation and use allowances. The expenses under this heading are the portion of the costs of the
organization's buildings, capital improvements to land and buildings, and equipment which are computed in
accordance with paragraph 11 of Attachment B ("Depreciation and use allowances").

(2) Interest. Interest on debt associated with certain buildings, equipment and capital improvements are
computed in accordance with paragraph 23 of Attachment B ("Interest, fund raising, and investment management
costs").

(3) Operation and maintenance expenses. The expenses under this heading are those that have been incurred
for the administration, operation, maintenance, preservation, and protection of the organization's physical plant.
They include expenses normally incurred for such items 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 plant facilities; security; earthquake and disaster preparedness; environmental safety; hazardous waste
disposal; property, liability and other insurance relating to property; space and capital leasing; facility planning and
management; and, central receiving. The operation and maintenance expenses category shall also include its
allocable share of fringe benefit costs, depreciation and use allowances, and interest costs.

(4) General administration and general expenses. The expenses under this heading are those that have been
incurred for the overall general executive and administrative offices of the organization and other expenses of a
general nature which do not relate solely to any major function of the organization. This category shall also include
its allocable share of fringe benefit costs, operation and maintenance expense, depreciation and use allowances,
and interest costs. Examples of this category include central offices, such as the director's office, the office of
finance, business services, budget and planning, personnel, safety and risk management, general counsel,
management information systems, and library costs.

In developing this cost pool, special care should be exercised to ensure that costs incurred for the same purpose in
like circumstances are treated consistently as either direct or indirect costs. For example, salaries of technical staff,
project supplies, project publication, telephone toll charges, computer costs, travel costs, and specialized services
costs shall be treated as direct costs wherever identifiable to a particular program. The salaries and wages of
administrative and pooled clerical staff should normally be treated as indirect costs. Direct charging of these costs
may be appropriate where a major project or activity explicitly requires and budgets for administrative or clerical
services and other individuals involved can be identified with the program or activity. Items such as office supplies,
postage, local telephone costs, periodicals and memberships should normally be treated as indirect costs.

c. Allocation bases. Actual conditions shall be taken into account in selecting the base to be used in allocating
the expenses in each grouping to benefitting functions. The essential consideration in selecting a method or a base
is that it is the one best suited for assigning the pool of costs to cost objectives in accordance with benefits
derived; a traceable cause and effect relationship; or logic and reason, where neither the cause nor the effect of
the relationship is determinable. When an allocation can be made by assignment of a cost grouping directly to the
function benefited, the allocation shall be made in that manner. When the expenses in a cost grouping are more
general in nature, the allocation shall be made through the use of a selected base which produces results that are equitable to both the Federal Government and the organization. The distribution shall be made in accordance with the bases described herein unless it can be demonstrated that the use of a different base would result in a more equitable allocation of the costs, or that a more readily available base would not increase the costs charged to sponsored awards. The results of special cost studies (such as an engineering utility study) shall not be used to determine and allocate the indirect costs to sponsored awards.

(1) Depreciation and use allowances. Depreciation and use allowances expenses shall be allocated in the following manner:

(a) Depreciation or use allowances on buildings used exclusively in the conduct of a single function, and on capital improvements and equipment used in such buildings, shall be assigned to that function.

(b) Depreciation or use allowances on buildings used for more than one function, and on capital improvements and equipment used in such buildings, shall be allocated to the individual functions performed in each building on the basis of usable square feet of space, excluding common areas, such as hallways, stairwells, and restrooms.

(c) Depreciation or use allowances on buildings, capital improvements and equipment related space (e.g., individual rooms, and laboratories) used jointly by more than one function (as determined by the users of the space) shall be treated as follows. The cost of each jointly used unit of space shall be allocated to the benefiting functions on the basis of:

(i) the employees and other users on a full-time equivalent (FTE) basis or salaries and wages of those individual functions benefiting from the use of that space; or

(ii) organization-wide employee FTEs or salaries and wages applicable to the benefiting functions of the organization.

(d) Depreciation or use allowances on certain capital improvements to land, such as paved parking areas, fences, sidewalks, and the like, not included in the cost of buildings, shall be allocated to user categories on a FTE basis and distributed to major functions in proportion to the salaries and wages of all employees applicable to the functions.

(2) Interest. Interest costs shall be allocated in the same manner as the depreciation or use allowances on the buildings, equipment and capital equipments to which the interest relates.

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

(4) General administration and general expenses. General administration and general expenses shall be allocated to benefitting functions based on modified total direct costs (MTDC), as described in subparagraph D.3.f. The expenses included in this category could be grouped first according to major functions of the organization to which they render services or provide benefits. The aggregate expenses of each group shall then be allocated to benefitting functions based on MTDC.

d. Order of distribution.

(1) Indirect cost categories consisting of depreciation and use allowances, interest, operation and maintenance, and general administration and general expenses shall be allocated in that order to the remaining indirect cost categories as well as to the major functions of the organization. Other cost categories could be allocated in the order determined to be most appropriate by the organization. When cross allocation of costs is made as provided in subparagraph (2), this order of allocation does not apply.

(2) Normally, an indirect cost category will be considered closed once it has been allocated to other cost objectives, and costs shall not be subsequently allocated to it. However, a cross allocation of costs between two or more indirect costs categories could be used if such allocation will result in a more equitable allocation of costs. If a cross allocation is used, an appropriate modification to the composition of the indirect cost categories is required.
e. Application of indirect cost rate or rates. Except where a special indirect cost rate(s) is required in accordance with subparagraph D.5, the separate groupings of indirect costs allocated to each major function shall be aggregated and treated as a common pool for that function. The costs in the common pool shall then be distributed to individual awards included in that function by use of a single indirect cost rate.

f. Distribution basis. Indirect costs shall be distributed to applicable sponsored awards and other benefiting activities within each major function on the basis of MTDC. MTDC consists of all salaries and wages, fringe benefits, materials and supplies, services, travel, and subgrants and subcontracts up to the first $25,000 of each subgrant or subcontract (regardless of the period covered by the subgrant or subcontract). Equipment, capital expenditures, charges for patient care, rental costs and the portion in excess of $25,000 shall be excluded from MTDC. Participant support costs shall generally be excluded from MTDC. Other items may only be excluded when the Federal cost cognizant agency determines that an exclusion is necessary to avoid a serious inequity in the distribution of indirect costs.

g. Individual Rate Components. An indirect cost rate shall be determined for each separate indirect cost pool developed. The rate in each case shall be stated as the percentage which the amount of the particular indirect cost pool is of the distribution base identified with that pool. Each indirect cost rate negotiation or determination agreement shall include development of the rate for each indirect cost pool as well as the overall indirect cost rate. The indirect cost pools shall be classified within two broad categories: "Facilities" and "Administration," as described in subparagraph C.3.

B. Attachment B

Revise the following cost items in Attachment B to Circular A-122 ("Selected Items of Cost").

1. Revise the Table of Contents for Attachment B to read:

   1. Advertising and public relations costs
   2. Alcoholic beverages
   3. Bad debts
   4. Bid and proposal costs (reserved)
   5. Bonding costs
   6. Communication costs
   7. Compensation for personal services
   8. Contingency provisions
   9. Contributions
  10. Defense and prosecution of criminal and civil proceedings, claims, appeals and patent infringement
  11. Depreciation and use allowances
  12. Donations
  13. Employee morale, health, and welfare costs and credits
  14. Entertainment costs
  15. Equipment and other capital expenditures
  16. Fines and penalties
  17. Fringe benefits
  18. Goods or services for personal use
  19. Housing and personal living expenses
  20. Idle facilities and idle capacity
  21. Independent research and development (reserved)
  22. Insurance and indemnification
  23. Interest, fund raising, and investment management costs
  24. Labor relations costs
  25. Lobbying costs
  26. Losses on other awards
  27. Maintenance and repair costs
  28. Materials and supplies
  29. Meetings and conferences
  30. Memberships, subscriptions, and professional activity costs
  31. Organization costs
  32. Overtime, extra-pay shift, and multi-shift premiums
  33. Page charges in professional journals
34. Participant support costs
35. Patent costs
36. Pension plans
37. Plant security costs
38. Pre-award costs
39. Professional service costs
40. Profits and losses on disposition of depreciable property or other capital assets
41. Publication and printing costs
42. Rearrangement and alteration costs
43. Reconversion costs
44. Recruiting costs
45. Relocation costs
46. Rental costs
47. Royalties and other costs for use of patents and copyrights
48. Selling and marketing
49. Severance pay
50. Specialized service facilities
51. Taxes
52. Termination costs
53. Training and education costs
54. Transportation costs
55. Travel costs
56. Trustees

2. Revise and retile paragraph 1 to read:

1. Advertising and public relations costs.

   a. The term advertising costs means the costs of advertising media and corollary administrative costs. Advertising media include magazines, newspapers, radio and television programs, direct mail, exhibits, and the like.

   b. The term public relations includes community relations and means those activities dedicated to maintaining the image of the organization or maintaining or promoting understanding and favorable relations with the community or public at large or any segment of the public.

   c. The only allowable advertising costs are those which are solely for:

      (1) The recruitment of personnel required for the performance by the organization of obligations arising under a sponsored award, when considered in conjunction with all other recruitment costs, as set forth in paragraph 44 ("Recruiting costs");

      (2) The procurement of goods and services for the performance of a sponsored award;

      (3) The disposal of scrap or surplus materials acquired in the performance of a sponsored award except when organizations are reimbursed for disposal costs at a predetermined amount in accordance with OMB Circular A-110, Sec. 34, "Equipment"; or

      (4) Other specific purposes necessary to meet the requirements of the sponsored award.

   d. The only allowable public relations costs are:

      (1) Costs specifically required by sponsored awards;

      (2) Costs of communicating with the public and press pertaining to specific activities or accomplishments which result from performance of sponsored awards (these costs are considered necessary as part of the outreach effort for the sponsored awards); or
(3) Costs of conducting general liaison with news media and government public relations officers, to the extent that such activities are limited to communication and liaison necessary to keep the public informed on matters of public concern, such as notices of contract/grant awards, financial matters, etc.

e. Costs identified in subparagraphs c and d if incurred for more than one sponsored award or for both sponsored work and other work of the organization, are allowable to the extent that the principles in paragraphs B ("Direct Costs") and C ("Indirect Costs") of Attachment A are observed.

f. Unallowable advertising and public relations costs include the following:

(1) All advertising and public relations costs other than as specified in subparagraphs c, d, and e;

(2) Costs of meetings or other events related to fund raising or other organizational activities including:

(i) Costs of displays, demonstrations, and exhibits;

(ii) Costs of meeting rooms, hospitality suites, and other special facilities used in conjunction with shows and other special events; and

(iii) Salaries and wages of employees or cost of services engaged in setting up and displaying exhibits, making demonstrations, and providing briefings;

(3) Costs of promotional items and memorabilia, including models, gifts, and souvenirs;

(4) Costs of advertising and public relations designed solely to promote the organization.

3. Renumber current paragraphs 2 through 8 as paragraphs 3 through 9, respectively.

4. Add the following new paragraph 2:

2. Alcoholic beverages. Costs of alcoholic beverages are unallowable.

5. In paragraph 7 ("Compensation for personal services"), as renumbered above in item 3, rename the current subparagraph g ("Pension costs"), as subparagraph h. Add a new subparagraph g:

   g. Organization-furnished automobiles. That portion of the cost of organization-furnished automobiles that relates to personal use by employees (including transportation to and from work) is unallowable as fringe benefit or indirect costs regardless of whether the cost is reported as taxable income to the employees. These costs are allowable as direct costs to sponsored award when necessary for the performance of the sponsored award and approved by awarding agencies.

6. Renumber current paragraphs 9 through 15 as paragraphs 11 through 17, respectively.

7. Add new paragraph 10:

   10. Defense and prosecution of criminal and civil proceedings, claims, appeals and patent infringement.

   a. Definitions.

      (1) Conviction, as used herein, means a judgment or a conviction of a criminal offense by any court of competent jurisdiction, whether entered upon as a verdict or a plea, including a conviction due to a plea of nolo contendere.

      (2) Costs include, but are not limited to, administrative and clerical expenses; the cost of legal services, whether performed by in-house or private counsel; and the costs of the services of accountants, consultants, or others retained by the organization to assist it; costs of employees, officers and trustees, and any similar costs incurred before, during, and after commencement of a judicial or administrative proceeding that bears a direct relationship to the proceedings.
(3) Fraud, as used herein, means (i) acts of fraud corruption or attempts to defraud the Federal Government or to corrupt its agents, (ii) acts that constitute a cause for debarment or suspension (as specified in agency regulations), and (iii) acts which violate the False Claims Act, 31 U.S.C., sections 3729-3731, or the Anti-Kickback Act, 41 U.S.C., sections 51 and 54.

(4) Penalty does not include restitution, reimbursement, or compensatory damages.

(5) Proceeding includes an investigation.

b. (1) Except as otherwise described herein, costs incurred in connection with any criminal, civil or administrative proceeding (including filing of a false certification) commenced by the Federal Government, or a State, local or foreign government, are not allowable if the proceeding: (1) relates to a violation of, or failure to comply with, a Federal, State, local or foreign statute or regulation by the organization (including its agents and employees), and (2) results in any of the following dispositions:

   (a) In a criminal proceeding, a conviction.

   (b) In a civil or administrative proceeding involving an allegation of fraud or similar misconduct, a determination of organizational liability.

   (c) In the case of any civil or administrative proceeding, the imposition of a monetary penalty.

   (d) A final decision by an appropriate Federal official to debar or suspend the organization, to rescind or void an award, or to terminate an award for default by reason of a violation or failure to comply with a law or regulation.

   (e) A disposition by consent or compromise, if the action could have resulted in any of the dispositions described in (a), (b), (c) or (d).

(2) If more than one proceeding involves the same alleged misconduct, the costs of all such proceedings shall be unallowable if any one of them results in one of the dispositions shown in subparagraph b(1).

c. If a proceeding referred to in subparagraph b is commenced by the Federal Government and is resolved by consent or compromise pursuant to an agreement entered into by the organization and the Federal Government, then the costs incurred by the organization in connection with such proceedings that are otherwise not allowable under subparagraph b may be allowed to the extent specifically provided in such agreement.

d. If a proceeding referred to in subparagraph b is commenced by a State, local or foreign government, the authorized Federal official may allow the costs incurred by the organization for such proceedings, if such authorized official determines that the costs were incurred as a result of (1) a specific term or condition of a federally-sponsored award, or (2) specific written direction of an authorized official of the sponsoring agency.

e. Costs incurred in connection with proceedings described in subparagraph b, but which are not made unallowable by that subparagraph, may be allowed by the Federal Government, but only to the extent that:

   (1) The costs are reasonable in relation to the activities required to deal with the proceeding and the underlying cause of action;

   (2) Payment of the costs incurred, as allowable and allocable costs, is not prohibited by any other provision(s) of the sponsored award;

   (3) The costs are not otherwise recovered from the Federal Government or a third party, either directly as a result of the proceeding or otherwise; and,

   (4) The percentage of costs allowed does not exceed the percentage determined by an authorized Federal official to be appropriate, considering the complexity of the litigation, generally accepted principles governing the award of legal fees in civil actions involving the United States as a party, and such other factors as may be appropriate. Such percentage shall not exceed 80 percent. However, if an agreement reached under subparagraph c has explicitly considered this 80 percent limitation and permitted a higher percentage, then the full amount of costs resulting from that agreement shall be allowable.
f. Costs incurred by the organization in connection with the defense of suits brought by its employees or ex-
employees under section 2 of the Major Fraud Act of 1988 (Pub. L. 100-700), including the cost of all relief
necessary to make such employee whole, where the organization was found liable or settled, are unallowable.

g. Costs of legal, accounting, and consultant services, and related costs, incurred in connection with defense
against Federal Government claims or appeals, antitrust suits, or the prosecution of claims or appeals against the
Federal Government, are unallowable.

h. Costs of legal, accounting, and consultant services, and related costs, incurred in connection with patent
infringement litigation, are unallowable unless otherwise provided for in the sponsored awards.

i. Costs which may be unallowable under this paragraph, including directly associated costs, shall be segregated
and accounted for by the organization separately. During the pendency of any proceeding covered by
subparagraphs b and f, the Federal Government shall generally withhold payment of such costs. However, if in the
best interests of the Federal Government, the Federal Government may provide for conditional payment upon
provision of adequate security, or other adequate assurance, and agreements by the organization to repay all
unallowable costs, plus interest, if the costs are subsequently determined to be unallowable.

8. In paragraph 15 ("Equipment and other capital expenditures"), as renumbered in item 6 above, replace
subparagraphs 15.a.(1) and 15.b.(2) to read:

15.a.(1) "Equipment" means an article of nonexpendable, tangible personal property having a useful life of
more than one year and an acquisition cost which equals or exceeds the lesser of (a) the capitalization level
established by the organization for the financial statement purposes, or (b) $5000. 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 use allowances or depreciation on the equipment, or by amortizing the amount to be written
off over a period of years as negotiated with the Federal cognizant agency.

15.b.(2) Capital expenditures for special purpose equipment are allowable as direct costs, provided that items
with a unit cost of $5000 or more have the prior approval of awarding agency.

9. Rerenumbe current paragraphs 16 through 36 as paragraphs 20 through 40, respectively.

10. Add new paragraph 18:

18. Goods or services for personal use. Costs of goods or services for personal use of the organization's
employees are unallowable regardless of whether the cost is reported as taxable income to the employees.

11. Add new paragraph 19:

19. Housing and personal living expenses.

a. Costs of housing (e.g., depreciation, maintenance, utilities, furnishings, rent, etc.), housing allowances and
personal living expenses for/of the organization's officers are unallowable as fringe benefit or indirect costs
regardless of whether the cost is reported as taxable income to the employees. These costs are allowable as direct
costs to sponsored awards when necessary for the performance of the sponsored award and approved by awarding
agencies.

b. The term "officers" includes current and past officers and employees.

12. Add to paragraph 22.a.(2) ("Insurance and indemnification"), as renumbered in item 9, subparagraphs (f) and
(g):

(f) Insurance against defects. Costs of insurance with respect to any costs incurred to correct defects in the
organization's materials or workmanship are unallowable.

(g) Medical liability (malpractice) insurance. Medical liability insurance is an allowable cost of Federal research
programs only to the extent that the Federal research programs involve human subjects or training of participants
in research techniques. Medical liability insurance costs shall be treated as a direct cost and shall be assigned to

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individual projects based on the manner in which the insurer allocates the risk to the population covered by the
insurance.

13. Revise paragraph 30, as renumbered in item 9, to read:

30. Memberships, subscriptions and professional activity costs.
   a. Costs of the organization’s membership in business, technical, and professional organizations are allowable.
   b. Costs of the organization’s subscriptions to business, professional, and technical periodicals are allowable.
   c. Costs of meetings and conferences, when the primary purpose is the dissemination of technical information
      are allowable. This includes costs of meals, transportation, rental of facilities, and other items incidental to such
      meetings or conferences.
   d. Costs of membership in any civic or community organization are allowable with prior approval by Federal
      cognizant agency.
   e. Costs of membership in any country club or social or dining club or organization are unallowable.


15. Delete current paragraph 37 (“Public service costs”).

16. Rerumber current paragraphs 38 through 44 as paragraphs 41 through 47, respectively.

17. Revise paragraph 44, as renumbered in item 16, to read:

44. Recruiting costs.
   a. Subject to subparagraphs b, c, and d, and provided that the size of the staff recruited and maintained is in
      keeping with workload requirements, costs of “help wanted” advertising, operating costs of an employment office
      necessary to secure and maintain an adequate staff, costs of operating an aptitude and educational testing
      program, travel costs of employees while engaged in recruiting personnel, travel costs of applicants for interviews
      for prospective employment, and relocation costs incurred incident to recruitment of new employees, are allowable
      to the extent that such costs are incurred pursuant to a well-managed recruitment program. Where the
      organization uses employment agencies, costs that are not in excess of standard commercial rates for such services
      are allowable.
   b. In publications, costs of help wanted advertising that includes color, includes advertising material for other
      than recruitment purposes, or is excessive in size (taking into consideration recruitment purposes for which
      intended and normal organizational practices in this respect), are unallowable.
   c. Costs of help wanted advertising, special emoluments, fringe benefits, and salary allowances incurred to
      attract professional personnel from other organizations that do not meet the test of reasonableness or do not
      conform with the established practices of the organization, are unallowable.
   d. Where relocation costs incurred incident to recruitment of a new employee have been allowed either as an
      allocable direct or indirect cost, and the newly hired employee resigns for reasons within his control within twelve
      months after being hired, the organization will be required to refund or credit such relocation costs to the Federal
      Government.

18. Rerumber current paragraphs 45 through 51 as paragraphs 49 through 55, respectively.

19. Add new paragraph 48:

48. Selling and marketing. Costs of selling and marketing any products or services of the organization (unless
      allowed under paragraph 1 as allowable public relations costs) are unallowable. These costs, however, are
allowable as direct costs, with prior approval by awarding agencies, when they are necessary for the performance of Federal programs.

20. Add new subparagraphs c, d and e to paragraph 49 ("Severance pay"), as renumbered in item 18, as follow:

   c. Costs incurred in certain severance pay packages (commonly known as "a golden parachute" payment) which are in an amount in excess of the normal severance pay paid by the organization to an employee upon termination of employment and are paid to the employee contingent upon a change in management control over, or ownership of, the organization's assets are unallowable.

   d. Severance payments to foreign nationals employed by the organization outside the United States, to the extent that the amount exceeds the customary or prevailing practices for the organization in the United States are unallowable, unless they are necessary for the performance of Federal programs and approved by awarding agencies.

   e. Severance payments to foreign nationals employed by the organization outside the United States due to the termination of the foreign national as a result of the closing of, or curtailment of activities by, the organization in that country, are unallowable, unless they are necessary for the performance of Federal programs and approved by awarding agencies.

21. Add new paragraph 56:

   56. Trustees. Travel and subsistence costs of trustees (or directors) are allowable. The costs are subject to restrictions regarding lodging, subsistence and air travel costs provided in paragraph 55.

C. Attachment C

1. Delete the following organizations from Attachment C. These organizations either no longer exist or are no longer exempted from complying with Circular A-122.

   Associated Universities, Incorporated, Washington, D.C.
   Associated Universities for Research and Astronomy, Tucson, Arizona
   Center for Energy and Environmental Research (CEER), (Univ. of Puerto Rico), Commonwealth of Puerto Rico
   Comparative Animal Research Laboratory (CARL), (University of Tennessee), Oak Ridge, Tennessee
   Institute of Gas Technology, Chicago, Illinois
   Montana Energy Research and Development Institute, Inc., (MERDI), Butte, Montana
   Project Management Corporation, Oak Ridge, Tennessee
   Sandia Corporation, Albuquerque, New Mexico
   Universities Corporation for Atmospheric Research, Boulder, Colorado


3. Change the location of the Institute for Defense Analysis in Virginia from Arlington to Alexandria.

4. Replace Midwest Research Institute, Headquartered in Kansas City, Missouri to National Renewable Energy Laboratory, Golden, Colorado.

D. A recompilation of the entire Circular A-122, with all its amendments, follows:
CIRCULAR NO. A-122
Revised

TO THE HEADS OF EXECUTIVE DEPARTMENTS AND ESTABLISHMENTS

SUBJECT: Cost Principles for Non-Profit Organizations

1. Purpose. This Circular establishes principles for determining costs of grants, contracts and other agreements with non-profit organizations. It does not apply to colleges and universities which are covered by Office of Management and Budget (OMB) Circular A-21, “Cost Principles for Educational Institutions”; State, local, and federally-recognized Indian tribal governments which are covered by OMB Circular A-87, “Cost Principles for State, Local, and Indian Tribal Governments”; or hospitals. The principles are designed to provide that the Federal Government bear its fair share of costs except where restricted or prohibited by law. The principles do not attempt to prescribe the extent of cost sharing or matching on grants, contracts, or other agreements. However, such cost sharing or matching shall not be accomplished through arbitrary limitations on individual cost elements by Federal agencies. Provision for profit or other increment above cost is outside the scope of this Circular.

2. Supersession. This Circular supersedes cost principles issued by individual agencies for non-profit organizations.

3. Applicability.
   a. These principles shall be used by all Federal agencies in determining the costs of work performed by non-profit organizations under grants, cooperative agreements, cost reimbursement contracts, and other contracts in which costs are used in pricing, administration, or settlement. All of these instruments are hereafter referred to as awards. The principles do not apply to awards under which an organization is not required to account to the Federal Government for actual costs incurred.
   b. All cost reimbursement subawards (subgrants, subcontracts, etc.) are subject to those Federal cost principles applicable to the particular organization concerned. Thus, if a subaward is to a non-profit organization, this Circular shall apply; if a subaward is to a commercial organization, the cost principles applicable to commercial concerns shall apply; if a subaward is to a college or university, Circular A-21 shall apply; if a subaward is to a State, local, or federally-recognized Indian tribal government, Circular A-87 shall apply.

4. Definitions.
   a. Non-profit organization means any corporation, trust, association, cooperative, or other organization which:
      (1) is operated primarily for scientific, educational, service, charitable, or similar purposes in the public interest;
      (2) is not organized primarily for profit; and
      (3) uses its net proceeds to maintain, improve, and/or expand its operations. For this purpose, the term “non-profit organization” excludes (i) colleges and universities; (ii) hospitals; (iii) State, local, and federally-recognized Indian tribal governments; and (iv) those non-profit organizations which are excluded from coverage of this Circular in accordance with paragraph 5.
   b. Prior approval means securing the awarding agency’s permission in advance to incur cost for those items that are designated as requiring prior approval by the Circular. Generally this permission will be in writing. Where an item of cost requiring prior approval is specified in the budget of an award, approval of the budget constitutes approval of that cost.

5. Exclusion of some non-profit organizations. Some non-profit organizations, because of their size and nature of operations, can be considered to be similar to commercial concerns for purpose of applicability of cost principles. Such non-profit organizations shall operate under Federal cost principles applicable to commercial concerns. A listing of these organizations is contained in Attachment C. Other organizations may be added from time to time.

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

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

   Attachment A - General Principles
   
   Attachment B - Selected Items of Cost
   
   Attachment C - Non-Profit Organizations Not Subject To This Circular

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

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

10. **Inquiries.** Further information concerning this Circular may be obtained by contacting the Office of Federal Financial Management, OMB, Washington, DC 20503, telephone (202) 395-3993.
ATTACHMENT A
Circular No. A-122

GENERAL PRINCIPLES
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ATTACHMENT A  
Circular No. A-122

GENERAL PRINCIPLES

A. Basic Considerations

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

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

3. Reasonable costs. A cost is reasonable if, in its nature or amount, it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the costs. The question of the reasonableness of specific costs must be scrutinized with particular care in connection with organizations or separate divisions thereof which receive the preponderance of their support from awards made by Federal agencies. In determining the reasonableness of a given cost, consideration shall be given to:
   a. Whether the cost is of a type generally recognized as ordinary and necessary for the operation of the organization or the performance of the award.
   b. The restraints or requirements imposed by such factors as generally accepted sound business practices, arms length bargaining, Federal and State laws and regulations, and terms and conditions of the award.
   c. Whether the individuals concerned acted with prudence in the circumstances, considering their responsibilities to the organization, its members, employees, and clients, the public at large, and the Federal Government.
   d. Significant deviations from the established practices of the organization which may unjustifiably increase the award costs.

4. Allocable costs.
   a. A cost is allocable to a particular cost objective, such as a grant, contract, project, service, or other activity, in accordance with the relative benefits received. A cost is allocable to a Federal award if it is treated consistently with other costs incurred for the same purpose in like circumstances and if it:
      (1) Is incurred specifically for the award.
      (2) Benefits both the award and other work and can be distributed in reasonable proportion to the benefits received, or
(3) Is necessary to the overall operation of the organization, although a direct relationship to any particular cost objective cannot be shown.

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

5. Applicable credits.

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

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

c. For rules covering program income (i.e., gross income earned from federally-supported activities) see Sec. __.24 of Office of Management and Budget (OMB) Circular A-110, "Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations."

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

7. Conditional exemptions.

a. OMB authorizes conditional exemption from OMB administrative requirements and cost principles circulars for certain Federal programs with statutorily-authorized consolidated planning and consolidated administrative funding, that are identified by a Federal agency and approved by the head of the Executive department or establishment. A Federal agency shall consult with OMB during its consideration of whether to grant such an exemption.

b. To promote efficiency in State and local program administration, when Federal non-entitlement programs with common purposes have specific statutorily-authorized consolidated planning and consolidated administrative funding and where most of the State agency's resources come from non-Federal sources, Federal agencies may exempt these covered State-administered, non-entitlement grant programs from certain OMB grants management requirements. The exemptions would be from all but the allocability of costs provisions of OMB Circulars A-87 (Attachment A, subsection C.3), "Cost Principles for State, Local, and Indian Tribal Governments," A-21 (Section C, subpart 4), "Cost Principles for Educational Institutions," and A-122 (Attachment A, subsection A.4), "Cost Principles for Non-Profit Organizations," and from all of the administrative requirements provisions of OMB Circular A-110, "Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations," and the agencies' grants management common rule.

c. When a Federal agency provides this flexibility, as a prerequisite to a State's exercising this option, a State must adopt its own written fiscal and administrative requirements for expending and accounting for all funds, which are consistent with the provisions of OMB Circular A-87, and extend such policies to all subrecipients. These fiscal and administrative requirements must be sufficiently specific to ensure that: funds are used in compliance with all applicable Federal statutory and regulatory provisions, costs are reasonable and necessary for operating these programs, and funds are not be used for general expenses required to carry out other responsibilities of a State or its subrecipients.
B. Direct Costs

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

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

3. The cost of certain activities are not allowable as charges to Federal awards (see, for example, fundraising costs in paragraph 23 of Attachment B). However, even though these costs are unallowable for purposes of computing charges to Federal awards, they nonetheless must be treated as direct costs for purposes of determining indirect cost rates and be allocated their share of the organization’s indirect costs if they represent activities which (1) include the salaries of personnel, (2) occupy space, and (3) benefit from the organization’s indirect costs.

4. The costs of activities performed primarily as a service to members, clients, or the general public when significant and necessary to the organization’s mission must be treated as direct costs whether or not allowable and be allocated an equitable share of indirect costs. Some examples of these types of activities include:
   a. Maintenance of membership rolls, subscriptions, publications, and related functions.
   b. Providing services and information to members, legislative or administrative bodies, or the public.
   c. Promotion, lobbying, and other forms of public relations.
   d. Meetings and conferences except those held to conduct the general administration of the organization.
   e. Maintenance, protection, and investment of special funds not used in operation of the organization.
   f. Administration of group benefits on behalf of members or clients, including life and hospital insurance, annuity or retirement plans, financial aid, etc.

C. Indirect Costs

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

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

3. Indirect costs shall be classified within two broad categories: "Facilities" and "Administration." "Facilities" is defined as depreciation and use allowances on buildings, equipment and capital improvement, interest on debt associated with certain buildings, equipment and capital improvements, and operations and maintenance expenses. "Administration" is defined as general administration and general expenses such as the director’s office, accounting, personnel, library expenses and all other types of expenditures not listed specifically under one of the subcategories of "Facilities" (including cross allocations from other pools, where applicable). See indirect cost rate reporting requirements in subparagraphs D.2.e and D.3.g.
D. Allocation of Indirect Costs and Determination of Indirect Cost Rates

1. General.

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

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

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

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

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

2. Simplified allocation method.

   a. Where an organization’s major functions benefit from its indirect costs to approximately the same degree, the allocation of indirect costs may be accomplished by (i) separating the organization’s total costs for the base period as either direct or indirect, and (ii) dividing the total allowable indirect costs (net of applicable credits) by an equitable distribution base. The result of this process is an indirect cost rate which is used to distribute indirect costs to individual awards. The rate should be expressed as the percentage which the total amount of allowable indirect costs bears to the base selected. This method should also be used where an organization has only one major function encompassing a number of individual projects or activities, and may be used where the level of Federal awards to an organization is relatively small.

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

   c. The distribution base may be total direct costs (excluding capital expenditures and other distorting items, such as major subcontracts or subgrants), direct salaries and wages, or other base which results in an equitable distribution. The distribution base shall generally exclude participant support costs as defined in paragraph 34 of Attachment B.

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

   e. For an organization that receives more than $10 million in Federal funding of direct costs in a fiscal year, a breakdown of the indirect cost component into two broad categories, Facilities and Administration as defined in subparagraph C.3, is required. The rate in each case shall be stated as the percentage which the amount of the particular indirect cost category (i.e., Facilities or Administration) is of the distribution base identified with that category.

3. Multiple allocation base method

   a. General. Where an organization's indirect costs benefit its major functions in varying degrees, indirect costs shall be accumulated into separate cost groupings, as described in subparagraph b. Each grouping shall then be
allocated individually to benefiting functions by means of a base which best measures the relative benefits. The default allocation bases by cost pool are described in subparagraph c.

b. Identification of indirect costs. Cost groupings shall be established so as to permit the allocation of each grouping on the basis of benefits provided to the major functions. Each grouping shall constitute a pool of expenses that are of like character in terms of functions they benefit and in terms of the allocation base which best measures the relative benefits provided to each function. The groupings are classified within the two broad categories: "Facilities" and "Administration," as described in subparagraph C.3. The indirect cost pools are defined as follows:

1. Depreciation and use allowances. The expenses under this heading are the portion of the costs of the organization's buildings, capital improvements to land and buildings, and equipment which are computed in accordance with paragraph 11 of Attachment B ("Depreciation and use allowances").

2. Interest. Interest on debt associated with certain buildings, equipment and capital improvements are computed in accordance with paragraph 23 of Attachment B ("Interest, fundraising, and investment management costs").

3. Operation and maintenance expenses. The expenses under this heading are those that have been incurred for the administration, operation, maintenance, preservation, and protection of the organization's physical plant. They include expenses normally incurred for such items 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 plant facilities; security; earthquake and disaster preparedness; environmental safety; hazardous waste disposal; property, liability and other insurance relating to property; space and capital leasing; facility planning and management; and, central receiving. The operation and maintenance expenses category shall also include its allocable share of fringe benefit costs, depreciation and use allowances, and interest costs.

4. General administration and general expenses. The expenses under this heading are those that have been incurred for the overall general executive and administrative offices of the organization and other expenses of a general nature which do not relate solely to any major function of the organization. This category shall also include its allocable share of fringe benefit costs, operation and maintenance expense, depreciation and use allowances, and interest costs. Examples of this category include central offices, such as the director's office, the office of finance, business services, budget and planning, personnel, safety and risk management, general counsel, management information systems, and library costs.

In developing this cost pool, special care should be exercised to ensure that costs incurred for the same purpose in like circumstances are treated consistently as either direct or indirect costs. For example, salaries of technical staff, project supplies, project publication, telephone toll charges, computer costs, travel costs, and specialized services costs shall be treated as direct costs wherever identifiable to a particular program. The salaries and wages of administrative and pooled clerical staff should normally be treated as indirect costs. Direct charging of these costs may be appropriate where a major project or activity explicitly requires and budgets for administrative or clerical services and other individuals involved can be identified with the program or activity. Items such as office supplies, postage, local telephone costs, periodicals and memberships should normally be treated as indirect costs.

c. Allocation bases. Actual conditions shall be taken into account in selecting the base to be used in allocating the expenses in each grouping to benefiting functions. The essential consideration in selecting a method or a base is that it is the one best suited for assigning the pool of costs to cost objectives in accordance with benefits derived; a traceable cause and effect relationship; or logic and reason, where neither the cause nor the effect of the relationship is determinable. When an allocation can be made by assignment of a cost grouping directly to the function benefited, the allocation shall be made in that manner. When the expenses in a cost grouping are more general in nature, the allocation shall be made through the use of a selected base which produces results that are equitable to both the Federal Government and the organization. The distribution shall be made in accordance with the bases described herein unless it can be demonstrated that the use of a different base would result in a more equitable allocation of the costs, or that a more readily available base would not increase the costs charged to sponsored awards. The results of special cost studies (such as an engineering utility study) shall not be used to determine and allocate the indirect costs to sponsored awards.

1. Depreciation and use allowances. Depreciation and use allowances expenses shall be allocated in the following manner:
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(a) Depreciation or use allowances on buildings used exclusively in the conduct of a single function, and on capital improvements and equipment used in such buildings, shall be assigned to that function.

(b) Depreciation or use allowances on buildings used for more than one function, and on capital improvements and equipment used in such buildings, shall be allocated to the individual functions performed in each building on the basis of usable square feet of space, excluding common areas, such as hallways, stairwells, and restrooms.

(c) Depreciation or use allowances on buildings, capital improvements and equipment related space (e.g., individual rooms, and laboratories) used jointly by more than one function (as determined by the users of the space) shall be treated as follows. The cost of each jointly used unit of space shall be allocated to the benefiting functions on the basis of:

(i) the employees and other users on a full-time equivalent (FTE) basis or salaries and wages of those individual functions benefiting from the use of that space; or

(ii) organization-wide employee FTEs or salaries and wages applicable to the benefiting functions of the organization.

(d) Depreciation or use allowances on certain capital improvements to land, such as paved parking areas, fences, sidewalks, and the like, not included in the cost of buildings, shall be allocated to user categories on a FTE basis and distributed to major functions in proportion to the salaries and wages of all employees applicable to the functions.

(2) Interest. Interest costs shall be allocated in the same manner as the depreciation or use allowances on the buildings, equipment and capital equipments to which the interest relates.

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

(4) General administration and general expenses. General administration and general expenses shall be allocated to benefiting functions based on modified total direct costs (MTDC), as described in subparagraph D.3.f. The expenses included in this category could be grouped first according to major functions of the organization to which they render services or provide benefits. The aggregate expenses of each group shall then be allocated to benefiting functions based on MTDC.

d. Order of distribution.

(1) Indirect cost categories consisting of depreciation and use allowances, interest, operation and maintenance, and general administration and general expenses shall be allocated in that order to the remaining indirect cost categories as well as to the major functions of the organization. Other cost categories could be allocated in the order determined to be most appropriate by the organization. When cross allocation of costs is made as provided in subparagraph (2), this order of allocation does not apply.

(2) Normally, an indirect cost category will be considered closed once it has been allocated to other cost objectives, and costs shall not be subsequently allocated to it. However, a cross allocation of costs between two or more indirect costs categories could be used if such allocation will result in a more equitable allocation of costs. If a cross allocation is used, an appropriate modification to the composition of the indirect cost categories is required.

e. Application of indirect cost rate or rates. Except where a special indirect cost rate(s) is required in accordance with subparagraph D.5, the separate groupings of indirect costs allocated to each major function shall be aggregated and treated as a common pool for that function. The costs in the common pool shall then be distributed to individual awards included in that function by use of a single indirect cost rate.

f. Distribution basis. Indirect costs shall be distributed to applicable sponsored awards and other benefiting activities within each major function on the basis of MTDC. MTDC consists of all salaries and wages, fringe benefits, materials and supplies, services, travel, and subgrants and subcontracts up to the first $25,000 of each subgrant or subcontract (regardless of the period covered by the subgrant or subcontract). Equipment, capital expenditures, charges for patient care, rental costs and the portion in excess of $25,000 shall be excluded from MTDC. Participant support costs shall generally be excluded from MTDC. Other items may only be excluded when the Federal cost...
cognizant agency determines that an exclusion is necessary to avoid a serious inequity in the distribution of indirect costs.

g. Individual Rate Components. An indirect cost rate shall be determined for each separate indirect cost pool developed. The rate in each case shall be stated as the percentage which the amount of the particular indirect cost pool is of the distribution base identified with that pool. Each indirect cost rate negotiation or determination agreement shall include development of the rate for each indirect cost pool as well as the overall indirect cost rate. The indirect cost pools shall be classified within two broad categories: “Facilities” and “Administration,” as described in subparagraph C.3.

4. Direct allocation method.

a. Some non-profit organizations treat all costs as direct costs except general administration and general expenses. These organizations generally separate their costs into three basic categories: (i) General administration and general expenses, (ii) fundraising, and (iii) other direct functions (including projects performed under Federal awards). Joint costs, such as depreciation, rental costs, operation and maintenance of facilities, telephone expenses, and the like are prorated individually as direct costs to each category and to each award or other activity using a base most appropriate to the particular cost being prorated.

b. This method is acceptable, provided each joint cost is prorated using a base which accurately measures the benefits provided to each award or other activity. The bases must be established in accordance with reasonable criteria, and be supported by current data. This method is compatible with the Standards of Accounting and Financial Reporting for Voluntary Health and Welfare Organizations issued jointly by the National Health Council, Inc., the National Assembly of Voluntary Health and Social Welfare Organizations, and the United Way of America.

c. Under this method, indirect costs consist exclusively of general administration and general expenses. In all other respects, the organization's indirect cost rates shall be computed in the same manner as that described in subparagraph 2.

5. Special indirect cost rates. In some instances, a single indirect cost rate for all activities of an organization or for each major function of the organization may not be appropriate, since it would not take into account those different factors which may substantially affect the indirect costs applicable to a particular segment of work. For this purpose, a particular segment of work may be that performed under a single award or it may consist of work under a group of awards performed in a common environment. These factors may include the physical location of the work, the level of administrative support required, the nature of the facilities or other resources employed, the scientific disciplines or technical skills involved, the organizational arrangements used, or any combination thereof. When a particular segment of work is performed in an environment which appears to generate a significantly different level of indirect costs, provisions should be made for a separate indirect cost pool applicable to such work. The separate indirect cost pool should be developed during the course of the regular allocation process, and the separate indirect cost rate resulting therefrom should be used, provided it is determined that (i) the rate differs significantly from that which would have been obtained under subparagraphs 2, 3, and 4, and (ii) the volume of work to which the rate would apply is material.

E. Negotiation and Approval of Indirect Cost Rates

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

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

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

c. Fixed rate means an indirect cost rate which has the same characteristics as a predetermined rate, except that the difference between the estimated costs and the actual costs of the period covered by the rate is carried forward as an adjustment to the rate computation of a subsequent period.
d. Final rate means an indirect cost rate applicable to a specified past period which is based on the actual costs of the period. A final rate is not subject to adjustment.

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

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

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

2. Negotiation and approval of rates.

a. Unless different arrangements are agreed to by the agencies concerned, the Federal agency with the largest dollar value of awards with an organization will be designated as the cognizant agency for the negotiation and approval of the indirect cost rates and, where necessary, other rates such as fringe benefit and computer charge-out rates. Once an agency is assigned cognizance for a particular non-profit organization, the assignment will not be changed unless there is a major long-term shift in the dollar volume of the Federal awards to the organization. All concerned Federal agencies shall be given the opportunity to participate in the negotiation process but, after a rate has been agreed upon, it will be accepted by all Federal agencies. When a Federal agency has reason to believe that special operating factors affecting its awards necessitate special indirect cost rates in accordance with subparagraph D.5, it will, prior to the time the rates are negotiated, notify the cognizant agency.

b. A non-profit organization which has not previously established an indirect cost rate with a Federal agency shall submit its initial indirect cost proposal immediately after the organization is advised that an award will be made and, in no event, later than three months after the effective date of the award.

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

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

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

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

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

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

i. To the extent that problems are encountered among the Federal agencies in connection with the negotiation and approval process, OMB will lend assistance as required to resolve such problems in a timely manner.
ATTACHMENT B
Circular No. A-122

SELECTED ITEMS OF COST
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ATTACHMENT B
Circular No. A-122

SELECTED ITEMS OF COST

Paragraphs 1 through 56 provide principles to be applied in establishing the allowability of certain items of cost. These principles apply whether a cost is treated as direct or indirect. Failure to mention a particular item of cost is not intended to imply that it is unallowable; rather, determination as to allowability in each case should be based on the treatment or principles provided for similar or related items of cost.

1. Advertising and public relations costs.
   a. The term advertising costs means the costs of advertising media and corollary administrative costs. Advertising media include magazines, newspapers, radio and television programs, direct mail, exhibits, and the like.

   b. The term public relations includes community relations and means those activities dedicated to maintaining the image of the organization or maintaining or promoting understanding and favorable relations with the community or public at large or any segment of the public.

   c. The only allowable advertising costs are those which are solely for:

      (1) The recruitment of personnel required for the performance by the organization of obligations arising under a sponsored award, when considered in conjunction with all other recruitment costs, as set forth in paragraph 44 ("Recruiting costs");

      (2) The procurement of goods and services for the performance of a sponsored award;

      (3) The disposal of scrap or surplus materials acquired in the performance of a sponsored award except when organizations are reimbursed for disposal costs at a predetermined amount in accordance with OMB Circular A-110, Sec.___.34, "Equipment"; or

      (4) Other specific purposes necessary to meet the requirements of the sponsored award.

   d. The only allowable public relations costs are:

      (1) Costs specifically required by sponsored awards;

      (2) Costs of communicating with the public and press pertaining to specific activities or accomplishments which result from performance of sponsored awards (these costs are considered necessary as part of the outreach effort for the sponsored awards); or

      (3) Costs of conducting general liaison with news media and government public relations officers, to the extent that such activities are limited to communication and liaison necessary to keep the public informed on matters of public concern, such as notices of contract/grant awards, financial matters, etc.

   e. Costs identified in subparagraphs c and d if incurred for more than one sponsored award or for both sponsored work and other work of the organization, are allowable to the extent that the principles in paragraphs B ("Direct Costs") and C ("Indirect Costs") of Attachment A are observed.

   f. Unallowable advertising and public relations costs include the following:

      (1) All advertising and public relations costs other than as specified in subparagraphs c, d, and e;

      (2) Costs of meetings or other events related to fund raising or other organizational activities including:
(i) Costs of displays, demonstrations, and exhibits;

(ii) Costs of meeting rooms, hospitality suites, and other special facilities used in conjunction with shows and other special events; and

(iii) Salaries and wages of employees or cost of services engaged in setting up and displaying exhibits, making demonstrations, and providing briefings;

(3) Costs of promotional items and memorabilia, including models, gifts, and souvenirs;

(4) Costs of advertising and public relations designed solely to promote the organization.

2. **Alcoholic beverages.** Costs of alcoholic beverages are unallowable.

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

4. **Bid and proposal costs.** (reserved)

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

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

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

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

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

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

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

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

   c. Reasonableness.

      (1) When the organization is predominantly engaged in activities other than those sponsored by the Federal Government, compensation for employees on federally-sponsored work will be considered reasonable to the extent that it is consistent with that paid for similar work in the organization's other activities.
(2) When the organization is predominantly engaged in federally-sponsored activities and in cases where the kind of employees required for the Federal activities are not found in the organization's other activities, compensation for employees on federally-sponsored work will be considered reasonable to the extent that it is comparable to that paid for similar work in the labor markets in which the organization competes for the kind of employees involved.

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

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

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

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

f. Fringe benefits.

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

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

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

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

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

g. Organization-furnished automobiles. That portion of the cost of organization-furnished automobiles that relates to personal use by employees (including transportation to and from work) is unallowable as fringe benefit or indirect costs regardless of whether the cost is reported as taxable income to the employees. These costs are allowable as direct costs to sponsored award when necessary for the performance of the sponsored award and approved by awarding agencies.

h. Pension plan costs.
(1) Costs of the organization’s pension plan which are incurred in accordance with the established policies of the organization are allowable, provided:

(a) Such policies meet the test of reasonableness;

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

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

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

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

(3) Excise taxes on accumulated funding deficiencies and other penalties imposed under ERISA are unallowable.

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

j. Overtime, extra-pay shift, and multi-shift premiums. See paragraph 32.

k. Severance pay. See paragraph 49.

l. Training and education costs. See paragraph 53.

m. Support of salaries and wages.

(1) Charges to awards for salaries and wages, whether treated as direct costs or indirect costs, will be based on documented payrolls approved by a responsible official(s) of the organization. The distribution of salaries and wages to awards must be supported by personnel activity reports, as prescribed in subparagraph (2), except when a substitute system has been approved in writing by the cognizant agency. (See subparagraph E.2 of Attachment A.)

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

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

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

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

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

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

8. Contingency provisions. Contributions to a contingency reserve or any similar provision made for events the occurrence of which cannot be foretold with certainty as to time, intensity, or with an assurance of their happening, are unallowable. The term "contingency reserve" excludes self-insurance reserves (see subparagraphs 7.f (3) and 22.a(2)(d); pension funds (see subparagraph 7.h); and reserves for normal severance pay (see subparagraph 49.b(1)).

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

10. Defense and prosecution of criminal and civil proceedings, claims, appeals and patent infringement.

   a. Definitions.

   (1) Conviction, as used herein, means a judgment or a conviction of a criminal offense by any court of competent jurisdiction, whether entered upon as a verdict or a plea, including a conviction due to a plea of nolo contendere.

   (2) Costs include, but are not limited to, administrative and clerical expenses; the cost of legal services, whether performed by in-house or private counsel; and the costs of the services of accountants, consultants, or others retained by the organization to assist it; costs of employees, officers and trustees, and any similar costs incurred before, during, and after commencement of a judicial or administrative proceeding that bears a direct relationship to the proceedings.

   (3) Fraud, as used herein, means (i) acts of fraud corruption or attempts to defraud the Federal Government or to corrupt its agents, (ii) acts that constitute a cause for debarment or suspension (as specified in agency regulations), and (iii) acts which violate the False Claims Act, 31 U.S.C., sections 3729-3731, or the Anti-Kickback Act, 41 U.S.C., sections 51 and 54.

   (4) Penalty does not include restitution, reimbursement, or compensatory damages.

   (5) Proceeding includes an investigation.

   b. (1) Except as otherwise described herein, costs incurred in connection with any criminal, civil or administrative proceeding (including filing of a false certification) commenced by the Federal Government, or a State, local or foreign government, are not allowable if the proceeding: (1) relates to a violation of, or failure to comply with, a Federal, State, local or foreign statute or regulation by the organization (including its agents and employees), and (2) results in any of the following dispositions:

   (a) In a criminal proceeding, a conviction.

   (b) In a civil or administrative proceeding involving an allegation of fraud or similar misconduct, a determination of organizational liability.

   (c) In the case of any civil or administrative proceeding, the imposition of a monetary penalty.

   (d) A final decision by an appropriate Federal official to debar or suspend the organization, to rescind or void an award, or to terminate an award for default by reason of a violation or failure to comply with a law or regulation.

   (e) A disposition by consent or compromise, if the action could have resulted in any of the dispositions described in (a), (b), (c) or (d).
(2) If more than one proceeding involves the same alleged misconduct, the costs of all such proceedings shall be unallowable if any one of them results in one of the dispositions shown in subparagraph b.(1).

c. If a proceeding referred to in subparagraph b is commenced by the Federal Government and is resolved by consent or compromise pursuant to an agreement entered into by the organization and the Federal Government, then the costs incurred by the organization in connection with such proceedings that are otherwise not allowable under subparagraph b may be allowed to the extent specifically provided in such agreement.

d. If a proceeding referred to in subparagraph b is commenced by a State, local or foreign government, the authorized Federal official may allow the costs incurred by the organization for such proceedings, if such authorized official determines that the costs were incurred as a result of (1) a specific term or condition of a federally-sponsored award, or (2) specific written direction of an authorized official of the sponsoring agency.

e. Costs incurred in connection with proceedings described in subparagraph b, but which are not made unallowable by that subparagraph, may be allowed by the Federal Government, but only to the extent that:

(1) The costs are reasonable in relation to the activities required to deal with the proceeding and the underlying cause of action;

(2) Payment of the costs incurred, as allowable and allocable costs, is not prohibited by any other provision(s) of the sponsored award;

(3) The costs are not otherwise recovered from the Federal Government or a third party, either directly as a result of the proceeding or otherwise; and,

(4) The percentage of costs allowed does not exceed the percentage determined by an authorized Federal official to be appropriate, considering the complexity of the litigation, generally accepted principles governing the award of legal fees in civil actions involving the United States as a party, and such other factors as may be appropriate. Such percentage shall not exceed 80 percent. However, if an agreement reached under subparagraph c has explicitly considered this 80 percent limitation and permitted a higher percentage, then the full amount of costs resulting from that agreement shall be allowable.

f. Costs incurred by the organization in connection with the defense of suits brought by its employees or ex-employees under section 2 of the Major Fraud Act of 1988 (Pub. L. 100-700), including the cost of all relief necessary to make such employee whole, where the organization was found liable or settled, are unallowable.

g. Costs of legal, accounting, and consultant services, and related costs, incurred in connection with defense against Federal Government claims or appeals, antitrust suits, or the prosecution of claims or appeals against the Federal Government, are unallowable.

h. Costs of legal, accounting, and consultant services, and related costs, incurred in connection with patent infringement litigation, are unallowable unless otherwise provided for in the sponsored awards.

i. Costs which may be unallowable under this paragraph, including directly associated costs, shall be segregated and accounted for by the organization separately. During the pendency of any proceeding covered by subparagraphs b and f, the Federal Government shall generally withhold payment of such costs. However, if in the best interests of the Federal Government, the Federal Government may provide for conditional payment upon provision of adequate security, or other adequate assurance, and agreements by the organization to repay all unallowable costs, plus interest, if the costs are subsequently determined to be unallowable.

11. Depreciation and use allowances.

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

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

(1) The cost of land;

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

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

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

e. Where depreciation method is followed, the period of useful service (useful life) established in each case for usable capital assets must take into consideration such factors as type of construction, nature of the equipment used, technological developments in the particular program area, and the renewal and replacement policies followed for the individual items or classes of assets involved. The method of depreciation used to assign the cost of an asset (or group of assets) to accounting periods shall reflect the pattern of consumption of the asset during its useful life. In the absence of clear evidence indicating that the expected consumption of the asset will be significantly greater or lesser in the early portions of its useful life than in the later portions, the straight-line method shall be presumed to be the appropriate method. Depreciation methods once used shall not be changed unless approved in advance by the cognizant Federal agency. When the depreciation method is introduced for application to assets previously subject to a use allowance, the combination of use allowances and depreciation applicable to such assets must not exceed the total acquisition cost of the assets. When the depreciation method is used for buildings, a building's shell may be segregated from each building component (e.g., plumbing system, heating, and air conditioning system, etc.) and each item depreciated over its estimated useful life; or the entire building (i.e., the shell and all components) may be treated as a single asset and depreciated over a single useful life.

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

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

a. Services received.

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

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

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

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

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

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

(4) Where donated services directly benefit a project supported by an award, the indirect costs allocated to the services will be considered as a part of the total costs of the project. Such indirect costs may be reimbursed under the award or used to meet cost sharing or matching requirements.

(5) The value of the donated services may be used to meet cost sharing or matching requirements under conditions described in Sec. ____23 of Circular A-110. Where donated services are treated as indirect costs, indirect cost rates will separate the value of the donations so that reimbursement will not be made.

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

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

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

b. Goods and space.

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

(2) The value of the donations may be used to meet cost sharing or matching share requirements under the conditions described in Sec. ____23 of Circular A-110. The value of the donations shall be determined in accordance with Sec. ____23 of Circular A-110. Where donations are treated as indirect costs, indirect cost rates will separate the value of the donations so that reimbursement will not be made.

13. Employee morale, health, and welfare costs and credits. The costs of house publications, health or first-aid clinics, and/or infirmaries, recreational activities, employees' counseling services, and other expenses incurred in accordance with the organization's established practice or custom for the improvement of working conditions, employer-employee relations, employee morale, and employee performance are allowable. Such costs will be equitably apportioned to all activities of the organization. Income generated from any of these activities will be credited to the cost thereof unless such income has been irrevocably set over to employee welfare organizations.
14. **Entertainment costs.** Costs of amusement, diversion, social activities, ceremonials, and costs relating thereto, such as meals, lodging, rentals, transportation, and gratuities are unallowable (but see paragraphs 13 and 30).

15. **Equipment and other capital expenditures.**
   a. As used in this paragraph, the following terms have the meanings set forth below:

   (1) "Equipment" means an article of nonexpendable, tangible personal property having a useful life of more than one year and an acquisition cost which equals or exceeds the lesser of (a) the capitalization level established by the organization for the financial statement purposes, or (b) $5000. 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 use allowances or depreciation on the equipment, or by amortizing the amount to be written off over a period of years as negotiated with the Federal cognizant agency.

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

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

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

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

   (2) Capital expenditures for special purpose equipment are allowable as direct costs, provided that items with a unit cost of $5000 or more have the prior approval of awarding agency.

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

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

   e. Equipment and other capital expenditures are unallowable as indirect costs. However, see paragraph 11 for allowability of use allowances or depreciation on buildings, capital improvements, and equipment. Also, see paragraph 46 for allowability of rental costs for land, buildings, and equipment.

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

17. **Fringe benefits.** See subparagraph 7.f.

18. **Goods or services for personal use.** Costs of goods or services for personal use of the organization's employees are unallowable regardless of whether the cost is reported as taxable income to the employees.

19. **Housing and personal living expenses.**
   a. Costs of housing (e.g., depreciation, maintenance, utilities, furnishings, rent, etc.), housing allowances and personal living expenses for/of the organization's officers are unallowable as fringe benefit or indirect costs regardless of whether the cost is reported as taxable income to the employees. These costs are allowable as direct...
costs to sponsored award when necessary for the performance of the sponsored award and approved by awarding agencies.

b. The term "officers" includes current and past officers and employees.

20. Idle facilities and idle capacity.

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

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

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

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

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

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

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

(2) Although not necessary to meet fluctuations in workload, they were necessary when acquired and are now idle because of changes in program requirements, efforts to achieve more economical operations, reorganization, termination, or other causes which could not have been reasonably foreseen. Under the exception stated in this subparagraph, costs of idle facilities are allowable for a reasonable period of time, ordinarily not to exceed one year, depending upon the initiative taken to use, lease, or dispose of such facilities (but see subparagraphs 48.b and d).

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

21. Independent research and development. [Reserved]

22. Insurance and indemnification.

a. Insurance includes insurance which the organization is required to carry, or which is approved, under the terms of the award and any other insurance which the organization maintains in connection with the general conduct of its operations. This paragraph does not apply to insurance which represents fringe benefits for employees (see subparagraphs 7.f and 7.h(2)).

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

(2) Costs of other insurance maintained by the organization in connection with the general conduct of its operations are allowable subject to the following limitations:

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

(b) Costs allowed for business interruption or other similar insurance shall be limited to exclude coverage of management fees.
(c) Costs of insurance or of any provisions for a reserve covering the risk of loss or damage to Federal property are allowable only to the extent that the organization is liable for such loss or damage.

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

(e) Costs of insurance on the lives of trustees, officers, or other employees holding positions of similar responsibilities are allowable only to the extent that the insurance represents additional compensation (see subparagraph 7.f(4)). The cost of such insurance when the organization is identified as the beneficiary is unallowable.

(f) Insurance against defects. Costs of insurance with respect to any costs incurred to correct defects in the organization's materials or workmanship are unallowable.

(g) Medical liability (malpractice) insurance. Medical liability insurance is an allowable cost of Federal research programs only to the extent that the Federal research programs involve human subjects or training of participants in research techniques. Medical liability insurance costs shall be treated as a direct cost and shall be assigned to individual projects based on the manner in which the insurer allocates the risk to the population covered by the insurance.

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

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

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

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

23. Interest, fundraising, and investment management costs.

a. Interest.

(1) Costs incurred for interest on borrowed capital or temporary use of endowment funds, however represented, are unallowable. However, interest on debt incurred after the effective date of this revision to acquire or replace capital assets (including renovations, alterations, equipment, land, and capital assets acquired through capital leases), acquired after the effective date of this revision and used in support of sponsored agreements is allowable, provided that:

(a) For facilities acquisitions (excluding renovations and alterations) costing over $10 million where the Federal Government’s reimbursement is expected to equal or exceed 40 percent of an asset’s cost, the non-profit organization prepares, prior to the acquisition or replacement of the capital asset(s), a justification that demonstrates the need for the facility in the conduct of federally-sponsored activities. Upon request, the needs justification must be provided to the Federal agency with cost cognizance authority as a prerequisite to the continued allowability of interest on debt and depreciation related to the facility. The needs justification for the acquisition of a facility should include, at a minimum, the following:

A statement of purpose and justification for facility acquisition or replacement
A statement as to why current facilities are not adequate
A statement of planned future use of the facility
A description of the financing agreement to be arranged for the facility

A summary of the building contract with estimated cost information and statement of source and use of funds

A schedule of planned occupancy dates

(b) For facilities costing over $500,000, the non-profit organization prepares, prior to the acquisition or replacement of the facility, a lease/purchase analysis in accordance with the provisions of Sec. ___.30 through ___.37 of Circular A-110, which shows that a financed purchase or capital lease is less costly to the organization than other leasing alternatives, on a net present value basis. Discount rates used should be equal to the non-profit organization’s anticipated interest rates and should be no higher than the fair market rate available to the non-profit organization from an unrelated (“arm’s length”) third-party. The lease/purchase analysis shall include a comparison of the net present value of the projected total cost comparisons of both alternatives over the period the asset is expected to be used by the non-profit organization. The cost comparisons associated with purchasing the facility shall include the estimated purchase price, anticipated operating and maintenance costs (including property taxes, if applicable) not included in the debt financing, less any estimated asset salvage value at the end of the period defined above. The cost comparison for a capital lease shall include the estimated total lease payments, any estimated bargain purchase option, operating and maintenance costs, and taxes not included in the capital leasing arrangement, less any estimated credits due under the lease at the end of the period defined above. Projected operating lease costs shall be based on the anticipated cost of leasing comparable facilities at fair market rates under rental agreements that would be renewed or reestablished over the period defined above, and any expected maintenance costs and allowable property taxes to be borne by the non-profit organization directly or as part of the lease arrangement.

(c) The actual interest cost claimed is predicated upon interest rates that are no higher than the fair market rate available to the non-profit organization from an unrelated (“arm’s length”) third party.

(d) Investment earnings, including interest income, on bond or loan principal, pending payment of the construction or acquisition costs, are used to offset allowable interest cost. Arbitrage earnings reportable to the Internal Revenue Service are not required to be offset against allowable interest costs.

(e) Reimbursements are limited to the least costly alternative based on the total cost analysis required under subparagraph (b). For example, if an operating lease is determined to be less costly than purchasing through debt financing, then reimbursement is limited to the amount determined if leasing had been used. In all cases where a lease/purchase analysis is performed, Federal reimbursement shall be based upon the least expensive alternative.

(f) Non-profit organizations are also subject to the following conditions:

(i) Interest on debt incurred to finance or refinance assets acquired before or reacquired after the effective date of this Circular is not allowable.

(ii) For debt arrangements over $1 million, unless the non-profit organization makes an initial equity contribution to the asset purchase of 25 percent or more, non-profit organizations shall reduce claims for interest expense by an amount equal to imputed interest earnings on excess cash flow, which is to be calculated as follows. Annually, non-profit organizations shall prepare a cumulative (from the inception of the project) report of monthly cash flows that includes inflows and outflows, regardless of the funding source. Inflows consist of depreciation expense, amortization of capitalized construction interest, and annual interest expense. For cash flow calculations, the annual inflow figures shall be divided by the number of months in the year (usually 12) that the building is in service for monthly amounts. Outflows consist of initial equity contributions, debt principal payments (less the pro rata share attributable to the unallowable costs of land) and interest payments. Where cumulative inflows exceed cumulative outflows, interest shall be calculated on the excess inflows for that period and be treated as a reduction to allowable interest expense. The rate of interest to be used to compute earnings on excess cash flows shall be the three month Treasury Bill closing rate as of the last business day of that month.

(iii) Substantial relocation of federally-sponsored activities from a facility financed by indebtedness, the cost of which was funded in whole or part through Federal reimbursements, to another facility prior to the expiration of a period of 20 years requires notice to the Federal cognizant agency. The extent of the relocation, the amount of the Federal participation in the financing, and the depreciation and interest charged to date may require negotiation and/or downward adjustments of replacement space charged to Federal programs in the future.
(iv) The allowable costs to acquire facilities and equipment are limited to a fair market value available to the non-profit organization from an unrelated ("arm's length") third party.

(2) For non-profit organizations subject to "full coverage" under the Cost Accounting Standards (CAS) as defined at 48 CFR 9903.201, the interest allowability provisions of subparagraph a do not apply. Instead, these organizations' sponsored agreements are subject to CAS 414 (48 CFR 9903.414), cost of money as an element of the cost of facilities capital, and CAS 417 (48 CFR 9903.417), cost of money as an element of the cost of capital assets under construction.

(3) The following definitions are to be used for purposes of paragraph 23:

(a) Re-acquired assets means assets held by the non-profit organization prior to the effective date of this revision that have again come to be held by the organization, whether through repurchase or refinancing. It does not include assets acquired to replace older assets.

(b) Initial equity contribution means the amount or value of contributions made by non-Federal entities for the acquisition of the asset or prior to occupancy of facilities.

(c) Asset costs means the capitalizable costs of an asset, including construction costs, acquisition costs, and other such costs capitalized in accordance with GAAP.

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

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

d. Fundraising and investment activities shall be allocated an appropriate share of indirect costs under the conditions described in subparagraph B.3 of Attachment A.

24. Labor relations costs. Costs incurred in maintaining satisfactory relations between the organization and its employees, including costs of labor management committees, employee publications, and other related activities are allowable.

25. Lobbying.

a. Notwithstanding other provisions of this Circular, costs associated with the following activities are unallowable:

(1) Attempts to influence the outcomes of any Federal, State, or local election, referendum, initiative, or similar procedure, through in kind or cash contributions, endorsements, publicity, or similar activity;

(2) Establishing, administering, contributing to, or paying the expenses of a political party, campaign, political action committee, or other organization established for the purpose of influencing the outcomes of elections;

(3) Any attempt to influence: (i) The introduction of Federal or State legislation; or (ii) the enactment or modification of any pending Federal or State legislation through communication with any member or employee of the Congress or State legislature (including efforts to influence State or local officials to engage in similar lobbying activity), or with any Government official or employee in connection with a decision to sign or veto enrolled legislation;

(4) Any attempt to influence: (i) The introduction of Federal or State legislation; or (ii) the enactment or modification of any pending Federal or State legislation by preparing, distributing or using publicity or propaganda, or by urging members of the general public or any segment thereof to contribute to or participate in any mass demonstration, march, rally, fundraising drive, lobbying campaign or letter writing or telephone campaign; or

(5) Legislative liaison activities, including attendance at legislative sessions or committee hearings, gathering information regarding legislation, and analyzing the effect of legislation, when such activities are carried on in support of or in knowing preparation for an effort to engage in unallowable lobbying.
b. The following activities are excepted from the coverage of subparagraph a:

(1) Providing a technical and factual presentation of information on a topic directly related to the performance of a grant, contract or other agreement through hearing testimony, statements or letters to the Congress or a State legislature, or subdivision, member, or cognizant staff member thereof, in response to a documented request (including a Congressional Record notice requesting testimony or statements for the record at a regularly scheduled hearing) made by the recipient member, legislative body or subdivision, or a cognizant staff member thereof; provided such information is readily obtainable and can be readily put in deliverable form; and further provided that costs under this section for travel, lodging or meals are unallowable unless incurred to offer testimony at a regularly scheduled Congressional hearing pursuant to a written request for such presentation made by the Chairman or Ranking Minority Member of the Committee or Subcommittee conducting such hearing.

(2) Any lobbying made unallowable by subparagraph a(3) to influence State legislation in order to directly reduce the cost, or to avoid material impairment of the organization's authority to perform the grant, contract, or other agreement.

(3) Any activity specifically authorized by statute to be undertaken with funds from the grant, contract, or other agreement.

c. (1) When an organization seeks reimbursement for indirect costs, total lobbying costs shall be separately identified in the indirect cost rate proposal, and thereafter treated as other unallowable activity costs in accordance with the procedures of subparagraph B.3 of Attachment A.

(2) Organizations shall submit, as part of the annual indirect cost rate proposal, a certification that the requirements and standards of this paragraph have been complied with.

(3) Organizations shall maintain adequate records to demonstrate that the determination of costs as being allowable or unallowable pursuant to paragraph 25 complies with the requirements of this Circular.

(4) Time logs, calendars, or similar records shall not be required to be created for purposes of complying with this paragraph during any particular calendar month when: (1) the employee engages in lobbying (as defined in subparagraphs (a) and (b)) 25 percent or less of the employee's compensated hours of employment during that calendar month, and (2) within the preceding five-year period, the organization has not materially misstated allowable or unallowable costs of any nature, including legislative lobbying costs. When conditions (1) and (2) are met, organizations are not required to establish records to support the allowability of claimed costs in addition to records already required or maintained. Also, when conditions (1) and (2) are met, the absence of time logs, calendars, or similar records will not serve as a basis for disallowing costs by contesting estimates of lobbying time spent by employees during a calendar month.

(5) Agencies shall establish procedures for resolving in advance, in consultation with OMB, any significant questions or disagreements concerning the interpretation or application of paragraph 25. Any such advance resolution shall be binding in any subsequent settlements, audits or investigations with respect to that grant or contract for purposes of interpretation of this Circular; provided, however, that this shall not be construed to prevent a contractor or grantee from contesting the lawfulness of such a determination.

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

27. Maintenance and repair costs. Costs incurred for necessary maintenance, repair, or upkeep of buildings and equipment (including Federal property unless otherwise provided for) which neither add to the permanent value of the property nor appreciably prolong its intended life, but keep it in an efficient operating condition, are allowable. Costs incurred for improvements which add to the permanent value of the buildings and equipment or appreciably prolong their intended life shall be treated as capital expenditures (see paragraph 15).

28. Materials and supplies. The costs of materials and supplies necessary to carry out an award are allowable. Such costs should be charged at their actual prices after deducting all cash discounts, trade discounts, rebates, and allowances received by the organization. Withdrawals from general stores or stockrooms should be charged at cost under any recognized method of pricing consistently applied. Incoming transportation charges may be a proper
29. Meetings and conferences.
   a. Costs associated with the conduct of meetings and conferences include the cost of renting facilities, meals, speakers' fees, and the like. But see paragraph 14, Entertainment costs, and paragraph 34, Participant support costs.

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

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

30. Memberships, subscriptions, and professional activity costs.
   a. Costs of the organization's membership in business, technical, and professional organizations are allowable.

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

   c. Costs of meetings and conferences, when the primary purpose is the dissemination of technical information, are allowable. This includes costs of meals, transportation, rental of facilities, and other items incidental to such meetings or conferences.

   d. Costs of membership in any civic or community organization are allowable with prior approval by Federal cognizant agency.

   e. Costs of membership in any country club or social or dining club or organization are unallowable.

31. Organization costs. Expenditures, such as incorporation fees, brokers' fees, fees to promoters, organizers or management consultants, attorneys, accountants, or investment counselors, whether or not employees of the organization, in connection with establishment or reorganization of an organization, are unallowable except with prior approval of the awarding agency.

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

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

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

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

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

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

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

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

34. Participant support costs. Participant support costs are direct costs for items such as stipends or subsistence allowances, travel allowances, and registration fees paid to or on behalf of participants or trainees (but
35. Patent costs.
   
a. Costs of (i) preparing disclosures, reports, and other documents required by the award and of searching the art to the extent necessary to make such disclosures, (ii) preparing documents and any other patent costs in connection with the filing and prosecution of a United States patent application where title or royalty-free license is required by the Federal Government to be conveyed to the Federal Government, and (iii) general counseling services relating to patent and copyright matters, such as advice on patent and copyright laws, regulations, clauses, and employee agreements are allowable (but see paragraph 39).

   b. Cost of preparing disclosures, reports, and other documents and of searching the art to the extent necessary to make disclosures, if not required by the award, are unallowable. Costs in connection with (i) filing and prosecuting any foreign patent application, or (ii) any United States patent application, where the award does not require conveying title or a royalty-free license to the Federal Government, are unallowable (also see paragraph 47).

36. Pension plans. See subparagraph 7.h.

37. Plant security costs. Necessary expenses incurred to comply with Federal security requirements or for facilities protection, including wages, uniforms, and equipment of personnel are allowable.

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

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

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

      (1) The nature and scope of the service rendered in relation to the service required.
      (2) The necessity of contracting for the service, considering the organization's capability in the particular area.
      (3) The past pattern of such costs, particularly in the years prior to Federal awards.
      (4) The impact of Federal awards on the organization's business (i.e., what new problems have arisen).
      (5) Whether the proportion of Federal work to the organization's total business is such as to influence the organization in favor of incurring the cost, particularly where the services rendered are not of a continuing nature and have little relationship to work under Federal grants and contracts.
      (6) Whether the service can be performed more economically by direct employment rather than contracting.
      (7) The qualifications of the individual or concern rendering the service and the customary fees charged, especially on non-Federal awards.
      (8) Adequacy of the contractual agreement for the service (e.g., description of the service, estimate of time required, rate of compensation, and termination provisions).
c. In addition to the factors in subparagraph b, retainer fees to be allowable must be supported by evidence of bona fide services available or rendered.

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

a. (1) Gains and losses on sale, retirement, or other disposition of depreciable property shall be included in the year in which they occur as credits or charges to cost grouping(s) in which the depreciation applicable to such property was included. The amount of the gain or loss to be included as a credit or charge to the appropriate cost grouping(s) shall be the difference between the amount realized on the property and the undepreciated basis of the property.

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

(a) The gain or loss is processed through a depreciation reserve account and is reflected in the depreciation allowable under paragraph 11.

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

(c) A loss results from the failure to maintain permissible insurance, except as otherwise provided in subparagraph 22.a(3).

(d) Compensation for the use of the property was provided through use allowances in lieu of depreciation in accordance with paragraph 11.

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

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

41. Publication and printing costs.

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

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

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

d. The cost of page charges in journals is addressed paragraph 33.

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

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

44. Recruiting costs.

a. Subject to subparagraphs b, c, and d, and provided that the size of the staff recruited and maintained is in keeping with workload requirements, costs of "help wanted" advertising, operating costs of an employment office necessary to secure and maintain an adequate staff, costs of operating an aptitude and educational testing program, travel costs of employees while engaged in recruiting personnel, travel costs of applicants for interviews.
for prospective employment, and relocation costs incurred incident to recruitment of new employees, are allowable to the extent that such costs are incurred pursuant to a well-managed recruitment program. Where the organization uses employment agencies, costs that are not in excess of standard commercial rates for such services are allowable.

b. In publications, costs of help wanted advertising that includes color, includes advertising material for other than recruitment purposes, or is excessive in size (taking into consideration recruitment purposes for which intended and normal organizational practices in this respect), are unallowable.

c. Costs of help wanted advertising, special emoluments, fringe benefits, and salary allowances incurred to attract professional personnel from other organizations that do not meet the test of reasonableness or do not conform with the established practices of the organization, are unallowable.

d. Where relocation costs incurred incident to recruitment of a new employee have been allowed either as an allocable direct or indirect cost, and the newly hired employee resigns for reasons within his control within twelve months after being hired, the organization will be required to refund or credit such relocation costs to the Federal Government.

45. Relocation costs.

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

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

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

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

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

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

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

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

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

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

c. Allowable relocation costs for new employees are limited to those described in (1) and (2) of subparagraph b. When relocation costs incurred incident to the recruitment of new employees have been allowed either as a direct or indirect cost and the employee resigns for reasons within his control within 12 months after hire, the organization shall refund or credit the Federal Government for its share of the cost. However, the costs of travel to an overseas location shall be considered travel costs in accordance with paragraph 55 and not relocation costs for the purpose of this paragraph if dependents are not permitted at the location for any reason and the costs do not include costs of transporting household goods.
d. The following costs related to relocation are unallowable:

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

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

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

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

46. Rental costs.

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

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

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

d. Rental costs under leases which are required to be treated as capital leases under GAAP, are allowable only up to the amount that would be allowed had the organization purchased the property on the date the lease agreement was executed, i.e., to the amount that minimally would pay for depreciation or use allowances, maintenance, taxes, and insurance. Interest costs related to capitalized leases are allowable to the extent they meet criteria in subparagraph 23.a. Unallowable costs include amounts paid for profit, management fees, and taxes that would not have been incurred had the organization purchased the facility.

47. Royalties and other costs for use of patents and copyrights.

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

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

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

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

(4) The patent or copyright is expired.

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

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

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

(3) Royalties paid under an agreement entered into after an award is made to an organization.
c. In any case involving a patent or copyright formerly owned by the organization, the amount of royalty allowed should not exceed the cost which would have been allowed had the organization retained title thereto.

48. **Selling and marketing.** Costs of selling and marketing any products or services of the organization (unless allowed under paragraph 1 as allowable public relations costs) are unallowable. These costs, however, are allowable as direct costs, with prior approval by awarding agencies, when they are necessary for the performance of Federal programs.

49. **Severance pay.**

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

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

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

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

c. Costs incurred in certain severance pay packages (commonly known as "a golden parachute" payment) which are in an amount in excess of the normal severance pay paid by the organization to an employee upon termination of employment and are paid to the employee contingent upon a change in management control over, or ownership of, the organization's assets are unallowable.

d. Severance payments to foreign nationals employed by the organization outside the United States, to the extent that the amount exceeds the customary or prevailing practices for the organization in the United States are unallowable, unless they are necessary for the performance of Federal programs and approved by awarding agencies.

e. Severance payments to foreign nationals employed by the organization outside the United States due to the termination of the foreign national as a result of the closing of, or curtailment of activities by, the organization in that country, are unallowable, unless they are necessary for the performance of Federal programs and approved by awarding agencies.

50. **Specialized service facilities.**

a. The costs of services provided by highly complex or specialized facilities operated by the organization, such as electronic computers and wind tunnels, are allowable, provided the charges for the services meet the conditions of either subparagraph b or c and, in addition, take into account any items of income or Federal financing that qualify as applicable credits under subparagraph A.5 of Attachment A.

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

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

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

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

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

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

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

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

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

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

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

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

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

   (a) The preparation and presentation to awarding agency of settlement claims and supporting data with respect to the terminated portion of the award, unless the termination is for default (see Sec.__.61 of Circular A-110); and

   (b) The termination and settlement of subawards.
(2) Reasonable costs for the storage, transportation, protection, and disposition of property provided by the Federal Government or acquired or produced for the award, except when grantees or contractors are reimbursed for disposals at a predetermined amount in accordance with Sec. __.30 through __.37 of Circular A-110.

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

f. Claims under subawards. Claims under subawards, including the allocable portion of claims which are common to the award, and to other work of the organization are generally allowable. An appropriate share of the organization’s indirect expense may be allocated to the amount of settlements with subcontractors and/or subgrantees, provided that the amount allocated is otherwise consistent with the basic guidelines contained in Attachment A. The indirect expense so allocated shall exclude the same and similar costs claimed directly or indirectly as settlement expenses.

53. Training and education costs.

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

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

      (1) Training materials.

      (2) Textbooks.

      (3) Fees charges by the educational institution.

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

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

      (6) Straight-time compensation of each employee for time spent attending classes during working hours not in excess of 156 hours per year and only to the extent that circumstances do not permit the operation of classes or attendance at classes after regular working hours; otherwise, such compensation is unallowable.

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

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

   e. Maintenance expense, and normal depreciation or fair rental, on facilities owned or leased by the organization for training purposes are allowable to the extent set forth in paragraphs 11, 27, and 46.
f. Contributions or donations to educational or training institutions, including the donation of facilities or other properties, and scholarships or fellowships, are unallowable.

g. Training and education costs in excess of those otherwise allowable under subparagraphs b and c may be allowed with prior approval of the awarding agency. To be considered for approval, the organization must demonstrate that such costs are consistently incurred pursuant to an established training and education program, and that the course or degree pursued is relative to the field in which the employee is now working or may reasonably be expected to work.

54. Transportation costs. Transportation costs include freight, express, cartage, and postage charges relating either to goods purchased, in process, or delivered. These costs are allowable. When such costs can readily be identified with the items involved, they may be directly charged as transportation costs or added to the cost of such items (see paragraph 28). Where identification with the materials received cannot readily be made, transportation costs may be charged to the appropriate indirect cost accounts if the organization follows a consistent, equitable procedure in this respect.

55. Travel costs.

a. Travel costs are the expenses for transportation, lodging, subsistence, and related items incurred by employees who are in travel status on official business of the organization. Travel costs are allowable subject to subparagraphs b through e, when they are directly attributable to specific work under an award or are incurred in the normal course of administration of the organization.

b. Such costs may be charged on an actual basis, on a per diem or mileage basis in lieu of actual costs incurred, or on a combination of the two, provided the method used results in charges consistent with those normally allowed by the organization in its regular operations.

c. The difference in cost between first-class air accommodations and less than first-class air accommodations is unallowable except when less than first-class air accommodations are not reasonably available to meet necessary mission requirements, such as where less than first-class accommodations would (i) require circuitous routing, (ii) require travel during unreasonable hours, (iii) greatly increase the duration of the flight, (iv) result in additional costs which would offset the transportation savings, or (v) offer accommodations which are not reasonably adequate for the medical needs of the traveler.

d. Necessary and reasonable costs of family movements and personnel movements of a special or mass nature are allowable, pursuant to paragraphs 44 and 45, subject to allocation on the basis of work or time period benefited when appropriate. Advance agreements are particularly important.

e. Direct charges for foreign travel costs are allowable only when the travel has received prior approval of the awarding agency. Each separate foreign trip must be approved. For purposes of this provision, foreign travel is defined as any travel outside of Canada and the United States and its territories and possessions. However, for an organization located in foreign countries, the term “foreign travel” means travel outside that country.

56. Trustees. Travel and subsistence costs of trustees (or directors) are allowable. The costs are subject to restrictions regarding lodging, subsistence and air travel costs provided in paragraph 55.
ATTACHMENT C
Circular No. A-122

NON-PROFIT ORGANIZATIONS NOT SUBJECT TO THIS CIRCULAR

Aerospace Corporation, El Segundo, California
Argonne National Laboratory, Chicago, Illinois
Atomic Casualty Commission, Washington, D.C.
Battelle Memorial Institute, Headquartered in Columbus, Ohio
Brookhaven National Laboratory, Upton, New York
Charles Stark Draper Laboratory, Incorporated, Cambridge, Massachusetts
Environmental Institute of Michigan, Ann Arbor, Michigan
Hanford Environmental Health Foundation, Richland, Washington
IIT Research Institute, Chicago, Illinois
Institute for Defense Analysis, Alexandria, Virginia
Mitre Corporation, Bedford, Massachusetts
National Radiological Astronomy Observatory, Green Bank, West Virginia
National Renewable Energy Laboratory, Golden, Colorado
Oak Ridge Associated Universities, Oak Ridge, Tennessee
Rand Corporation, Santa Monica, California
Research Triangle Institute, Research Triangle Park, North Carolina
Riverside Research Institute, New York, New York
Southern Research Institute, Birmingham, Alabama
Southwest Research Institute, San Antonio, Texas
SRI International, Menlo Park, California
Syracuse Research Corporation, Syracuse, New York
Universities Research Association, Incorporated (National Acceleration Lab), Argonne, Illinois
Non-profit insurance companies, such as Blue Cross and Blue Shield Organizations
Other non-profit organizations as negotiated with awarding agencies
OFFICE OF MANAGEMENT AND BUDGET

OMB Circular A-133
Audits of States, Local Governments, and Non-Profit Organizations

AGENCY: Office of Management and Budget


SUMMARY: This revision of Office of Management and Budget (OMB) Circular No. A-133, re-titled “Audits of States, Local Governments, and Non-Profit Organizations,” establishes uniform audit requirements for non-Federal entities that administer Federal awards and implements the Single Audit Act Amendments of 1996, which were signed into law on July 5, 1996 (Public Law 104-156). OMB Circular No. A-128, "Audits of States and Local Governments," issued in 1985, is rescinded, as a result of the consolidation of audit requirements under Circular A-133.

One of the more significant revisions is that the threshold for when an entity is required to have an audit is raised from $25,000 to $300,000. This will significantly reduce audit costs for many small entities. Other significant changes are: a report submission due date which is shortened from 13 to nine months and a report submission process that includes a data collection form and streamlined filing requirements (§___ .320); a new risk-based approach for major program determination (§___ .520); and, additional guidance for program-specific audits (§___ .235), audit findings (§___ .510), and audit findings follow-up (§___ .315).

This Notice also offers interested parties an opportunity to comment on the provisional "Circular A-133 Compliance Supplement," provided as Appendix B to Circular A-133. However, due to its length, the provisional "Circular A-133 Compliance Supplement" is not included in this Notice. See "ADDRESSES" for information about how to obtain a copy.

DATES: The revised Circular is effective [30 days after publication]. Federal agencies shall adopt the standards set forth in this revised Circular in codified regulations not later than [insert 60 days after publication of this revised Circular in the Federal Register].

The standards set forth in §___ .400, which apply directly to Federal agencies, shall apply to audits of fiscal years beginning after June 30, 1996, except as otherwise specified in §___ .400(a). The standards set forth in this Circular which Federal agencies shall apply to non-Federal entities shall apply to audits of fiscal years beginning after June 30, 1996, with the exception that §___ .305(b) applies to audits of fiscal years beginning after June 30, 1998. The requirements of Circular A-128, although the Circular is rescinded, and the 1990 version of Circular A-133 continue to apply for audits of fiscal years beginning on or before June 30, 1996.

All comments on the provisional "Circular A-133 Compliance Supplement" should be in writing, and must be received by November 30, 1997. Late comments will be considered to the extent practicable.

ADDRESSES: A copy of the Circular may be obtained from the OMB fax information line, 202-395-9068, document number 1133; OMB home page on the Internet which is currently located at /OMB, under the captions "OMB Documents," and then "Grants Management;" or by writing or calling the Office of Administration, Publications Office, room 2200, New Executive Office Building, Washington, DC 20503, telephone (202) 395-7332. A single copy of the provisional "Circular A-133 Compliance Supplement" may be obtained from EOP Publications, Office of Administration, 2200 NEOB, Washington, DC 20503 (telephone 202-395-7332). The provisional "Circular A-133 Compliance Supplement" is also available from the OMB home page.

Comments on the provisional "Circular A-133 Compliance Supplement" should be mailed to the Office of Management and Budget, Office of Federal Financial Management, Financial Standards and Reporting Branch, Room 6025, New Executive Office Building, Washington, DC 20503. Where possible, comments should reference the applicable page numbers. When comments of five pages or less are sent in by facsimile (fax), they should be faxed to (202) 395-4915. Electronic mail comments may be submitted via the Internet to RAMSEY_T@A1.EOP.GOV. Please include the full body of electronic mail comments in the text of the message and not as an attachment. Please include the name, title, organization, postal address, and E-mail address in the text of the message.
To facilitate conversion of the comments into a computer format for analysis, it would be helpful if respondents would send a copy of comments on either a 3.5 or 5.25 inch diskette in either WordPerfect 5.1 or 6.0, WordPerfect for Windows, or ASCII format. When a diskette cannot be provided, it would be helpful if the comments were printed in pica or an equivalent 10 characters per inch type on white paper so the document can be easily scanned into a computer format.

FOR FURTHER INFORMATION CONTACT: Recipients should contact their cognizant or oversight agency for audit, or Federal awarding agency, as may be appropriate in the circumstances. Subrecipients should contact their pass-through entity. Federal agencies should contact Sheila O. Conley, Office of Management and Budget, Office of Federal Financial Management, Financial Standards and Reporting Branch, telephone (202) 395-3993.

SUPPLEMENTARY INFORMATION:

A. Background

The Office of Management and Budget (OMB) received approximately 80 letters providing approximately 600 individual comments in response to its Federal Register proposal of November 5, 1996 (61 FR 57232-57249). Letters came from Federal agencies (including Offices of Inspectors General), State governments (including State auditors), certified public accountants (CPAs), internal auditors, non-profit organizations (including colleges and universities), professional organizations, and others. All comments were considered in developing this final revision.

The November 5, 1996, Federal Register notice, requested public comment on the proposed revision and retitling of Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations," and proposed rescission of Circular A-128, "Audits of States and Local Governments." Section B presents a summary of the major public comments grouped by subject and a response to each comment. Other technical amendments were made to conform to professional auditing standards and to increase clarity and readability.

The November 5, 1996, Federal Register notice also requested comment on two proposed information collection requirements contained in the proposed revision to Circular A-133. A summary of the comments received relating to the proposed information collection requirements and response to each comment is published in a companion Notice in today's Federal Register.

Interested parties may wish to refer to this Notice for a detailed discussion of the following information collection matters: estimates of reporting burden; necessity of the data collection form; data collection form duplicates other reported information; data elements in the data collection form; suggested additional data elements for inclusion in the form; who should sign the data collection form for the auditee; level of form's specificity provided in the Circular and supplemental forms; data collection form sent only to the Federal clearinghouse; applicability of Freedom of Information Act and other Federal laws; report copies; report submission and distribution; Federal clearinghouse responsibilities; requirement for the auditor to prepare and sign the data collection form; increased costs for auditors to prepare and sign form; retention of audit workpapers; schedule of expenditures of Federal awards; summary schedule of prior audit findings; summary of the auditor's results; auditor's schedule of findings and questioned costs; report due date; and effective date for the data collection form requirement.

Readers of this Notice should especially note the discussion of the requirement for the auditor to prepare and sign the data collection form due to its impact on the text of the Circular. Other matters addressed in the accompanying Notice also resulted in revisions to the text of the Circular but are not repeated in this Notice.

B. Public Comments and Responses

Overall Reaction to the Proposed Revision to Circular A-133

Comment: Most commenters overwhelmingly supported the proposed revisions and believe that the revisions will greatly increase the efficiency and effectiveness of the single audit process. Several State auditors commented that the proposed revision to Circular A-133 was similar to what they expected, particularly in light of the changes included in the Single Audit Act Amendments of 1996 (1996 Amendments), which were signed into law on July 5, 1996 (Public Law 104-156). Many commenters were pleased with some of the most significant changes, such as: (a) the increased threshold that triggers an audit requirement from $25,000 to $300,000; (b) the risk-based approach to determining major programs; (c) the uniformity of audit requirements for States, local governments, and non-profit organizations; and, (d) the removal of the current requirement to report virtually all audit findings
and questioned costs. A few commenters requested that the audit threshold remain at $25,000. Although most commenters supported these significant revisions, many commenters expressed concern about other proposals included in the proposed revision, on which OMB specifically requested public comment, such as the audit coverage for the allowability of charges to cost pools, and whether the auditor should prepare and sign the data collection form.

Response: The most significant provisions included in the proposed revision to Circular A-133 that commenters strongly supported are included in the final revision to Circular A-133. Several proposals, such as the audit threshold of $300,000, are based in the 1996 Amendments and, therefore, are adopted in the final Circular. Each of the proposals on which OMB requested public comment are addressed in the following sections or accompanying Notice. Some of the comments resulted in changes to the final revision.

Consolidation of Circular A-128 into Circular A-133

Comment: All but one commenter strongly supported the proposal to consolidate Circular A-128 into Circular A-133, and rescind Circular A-128. Reasons cited include less confusion for auditees and auditors, uniformity of audit requirements for non-Federal entities that administer Federal awards, and consistency with concepts included in the 1996 Amendments. One Federal agency that oversees Indian tribal governments expressed concern about rescinding Circular A-128 because many Indian tribal governments have not yet submitted audit reports required by Circular A-128 for audits of fiscal years beginning on or before June 30, 1996.

Response: Pursuant to the 1996 Amendments, which establish uniform audit requirements for non-Federal entities that administer Federal awards, the final revision to Circular A-133 extends its coverage to include State and local governments. In response to the Federal agency's concern about Indian tribal governments, it should be noted that States, including Indian tribal governments for purposes of the Circular, and local governments are subject to the requirements of Circular A-128, issued April 12, 1985, for audits of fiscal years beginning on or before June 30, 1996. Sanctions are provided in Circular A-128 and are available for use by Federal agencies, as considered necessary, in instances of continued inability or unwillingness to comply with the requirements of Circular A-128. The rescission of Circular A-128 applies to audits of State and local governments for fiscal years beginning after June 30, 1996.

Comment: In light of the proposed rescission of Circular A-128, several commenters requested that the title of Circular A-133 be expanded to also include Indian tribal governments.

Response: No change was made as a result of these comments. For single audit purposes, Indian tribal governments are included under the definition of "State" in Circular A-133 based on the statutory definition of "State" in the Single Audit Act of 1984 and the 1996 Amendments.

Effective Date

Comment: Several Federal agencies questioned which audit requirements are effective prior to codification of the revised Circular in a Federal agency's regulations. Paragraph ten of the proposed revision states that the standards set forth in the revised Circular shall be adopted by Federal agencies in codified regulations not later than six months after publication "in the Federal Register, so that they apply to audits of fiscal years beginning after June 30, 1996 ... In the interim period, until the standards in this Circular are adopted and become applicable, the audit provisions of Circular A-128, issued April 12, 1985, and Circular A-133, issued April 22, 1996, shall continue in effect." Several Federal agencies also requested clarification about how the requirements of Circular A-133 should be codified in Federal agency regulations.

Response: The sentence regarding the interim period was removed from the revised Circular. The 1996 Amendments (31 U.S.C. 7505(a)) require that "each Federal agency shall promulgate such amendments to its regulations as may be necessary to conform such regulations to the requirements of this chapter and of such guidance [provided by the Director of OMB to implement the 1996 Amendments]." Federal agencies shall adopt the provisions of the revised Circular not later than 60 days after publication of the revised Circular in the Federal Register. OMB is coordinating an effort to facilitate Federal agency compliance with this adoption requirement.
Comment: Many commenters requested that further guidance be provided in the Circular to assist in determining what types of procedures would qualify as "limited scope audits to monitor subrecipients."

Response: The 1996 Amendments (31 U.S.C. 7505(b)(1)(A)(ii)) prohibit a non-Federal entity from charging to a Federal award the cost of a Circular A-133 audit when the amount of Federal awards expended is less than $300,000 per year, except that OMB may allow the cost of limited scope audits to monitor subrecipients. A sentence was added to the final revision of Circular A-133 (§ ___.230(b)(2)) which defines limited scope audits to include only agreed-upon procedures engagements conducted in accordance with either the American Institute of Certified Public Accountants' (AICPA) generally accepted auditing standards (GAAS) or attestation standards, that are paid for and arranged by a pass-through entity and only address one or more of the following types of compliance requirements: activities allowed or unallowed; allowable costs/cost principles; eligibility; matching, level of effort, earmarking; and, reporting.

For subrecipients that expend less than $300,000 in Federal awards annually, the cost of any audits or attestation engagements, other than limited scope audits described in the previous paragraph, are not allowable costs and, therefore, cannot be charged to any Federal award. This provision would prohibit the cost of a financial statement audit conducted in accordance with GAAS or generally accepted government auditing standards (GAGAS) issued by the Comptroller General of the United States from being charged (by either a pass-through entity or subrecipient) to Federal awards for a subrecipient that expends less than $300,000 in Federal awards annually.

Subrecipient Monitoring

Comment: One State agency recommended that pass-through entities no longer be required to monitor subrecipients expending less than $300,000 in Federal awards. Some pass-through entities expressed concern that they might be expected to perform audit procedures for each of their subrecipients not covered by Circular A-133. Some subrecipients stated concern that the requirement to monitor subrecipients expending under $300,000 in Federal awards could result in a return to grant-by-grant auditing of such entities.

Response: The 1996 Amendments (31 U.S.C. 7502(f)(2)(B)) require pass-through entities to monitor a subrecipient's use of Federal awards through site visits, limited scope audits, or other means. In light of the increased threshold that triggers an audit requirement under the Circular to $300,000 or more in Federal awards expended per year, pass-through entities will need to make appropriate changes in their agreements with subrecipients to reflect that Circular A-133 audits will no longer be required for non-Federal entities with total Federal awards expended of less than $300,000 annually.

Since pass-through entities are held accountable for Federal awards administered by their subrecipients, they will also need to review their overall subrecipient monitoring process, and decide what, if any, additional monitoring procedures may be necessary to ensure subrecipient compliance. Monitoring procedures, such as on-site visits, reviews of documentation supporting requests for reimbursement, and limited scope audits (e.g., agreed-upon procedures performed over eligibility determinations made by subrecipients), can be more targeted and less costly than a full Circular A-133 audit. OMB expects pass-through entities to consider various risk factors in developing subrecipient monitoring procedures, such as the relative size and complexity of the Federal awards administered by subrecipients, prior experience with each subrecipient, and the cost-effectiveness of various monitoring procedures.

For example, if a pass-through entity provides a large percentage of the only Federal award it expends to 10 subrecipients that each expend less than $300,000 in Federal awards annually, then the pass-through entity should carefully consider the most cost-effective method of monitoring these Federal awards. Perhaps the majority of this Federal award is provided to two subrecipients. The pass-through entity might consider conducting site visits at these two subrecipients and simply reviewing the documentation supporting requests for reimbursement from the other eight subrecipients. Conversely, if a small percentage of a Federal award is provided to subrecipients that each expend less than $300,000 in Federal awards, the risk to the pass-through entity is most likely low and, therefore, the monitoring procedures could be minimal.

OMB believes that this approach to designing subrecipient monitoring procedures should result in cost-effective monitoring and minimize the return to grant-by-grant auditing. This is a matter of particular importance to OMB and small recipients of Federal awards. Over the next few years, OMB and Federal agencies will review implementation of subrecipient monitoring procedures by pass-through entities to determine whether additional guidance or subsequent revisions to the Circular is warranted in this area.
Audit Coverage for the Allowability of Charges to Cost Pools

Comment: Several Federal auditors and Federal agencies supported the proposed treatment of costs charged to cost pools used to support an indirect cost rate or allocated through a State/local-wide central service cost allocation plan (CAP). Most State auditors, State agencies, CPAs, and college and university commenters strongly opposed the proposal stating that the proposed revision appears to: (1) elevate coverage of indirect costs and CAPs to major program status, which would exceed the requirements of the 1996 Amendments; (2) require coverage regardless of materiality; (3) violate the risk-based approach to determining major programs; and, (4) single out indirect costs for extensive coverage beyond other elements of cost charged to Federal awards. Some commenters noted logistical difficulties that may result from the timing differences between when costs are charged to cost pools used to support an indirect cost rate or CAP; when the plans are submitted and negotiated; and when indirect costs are actually charged to Federal awards. Several college and university commenters opposed any additional requirements in this area because they believe that Federal cost negotiators perform some sort of audit of costs charged to cost pools under Circular A-21, "Cost Principles for Educational Institutions." Most commenters requested that additional guidance, either in the Circular or the compliance supplement, be provided to assist auditors in this area.

Response: The proposed revision included certain phrases that were intended to clarify the auditor's responsibility for testing and reporting on the allowability of costs charged to cost pools: (1) used to support an indirect cost rate, or (2) allocated through a State/local-wide central service CAP (as fully described in Appendix C of Circular A-87, "Cost Principles for State, Local and Indian Tribal Governments," issued May 4, 1995 (60 FR 26484)). The suggested language was included in the proposed revision to address the timing of when costs charged to cost pools used to support an indirect cost rate or allocated through a CAP should be audited. This area presents unique timing considerations due to the manner in which indirect cost rates and CAPs are developed. Indirect cost rates are usually based on costs incurred in a base period and applied prospectively. Costs allocated through a CAP are typically based on the actual costs incurred in the current year and also previous years.

OMB did not intend for costs charged to cost pools used to support an indirect cost rate or allocated through a CAP to be audited every year as a major program regardless of materiality. As a result of the comments received, the suggested language relating to the treatment of indirect costs and costs allocated through a CAP was removed from §___..500, §___..505, and §___..510 of the final revision of Circular A-133.

Although specific mention of indirect costs and costs allocated through a CAP was removed from the Circular, this removal does not diminish the auditor's responsibility for such costs. Accordingly, when indirect costs or allocated costs have a direct and material effect on any major program, the auditor is responsible for determining the propriety of costs charged to cost pools that are used to calculate an indirect cost rate or allocated through a CAP in the year in which the charges affect a major program. Because it may not be practical to perform such tests retroactively (e.g., when there is a change in auditors), OMB encourages the auditor to perform tests of costs charged to cost pools during the period when the actual costs were incurred or during the period when the proposal or plan is finalized, rather than waiting until the period when the rate was applied or in which the costs were allocated. Further guidance relating to audit coverage of indirect costs is provided in the provisional "Circular A-133 Compliance Supplement."

To illustrate the unique timing considerations relating to indirect costs and the impact on the audit process, assume that the actual costs charged to cost pools for 1997 form the basis for the indirect cost proposal to be submitted in 1998, and the final negotiated indirect cost rate that will be applied in 1999. Also, assume that indirect costs charged to a major program in 1999 are material. In this situation, the auditor is strongly encouraged to test actual costs charged to cost pools during 1997 as part of the 1997 audit, since 1997 is the base year, or as part of the 1998 audit, since 1998 is the year when the proposal will be finalized, submitted, and negotiated. If the auditor tests the actual costs charged to the cost pools as part of either the 1997 or 1998 audit (or can appropriately rely on the work performed by other auditors in these years), then the auditor's responsibility in 1999 will relate primarily to determining whether the appropriate rate was applied in 1999. However, if no prior audit work was done relating to the actual costs charged to cost pools used to support the rate used to charge a major program in 1999, then the auditor conducting the 1999 audit would be expected to test such costs, in addition to determining whether the appropriate rate was applied in 1999.

This area is of particular concern to OMB and Federal cost negotiators. Contrary to the views expressed by several commenters, Federal cost negotiators do not typically audit costs charged to cost pools used to support an indirect cost rate or allocated through a CAP. In the next few years, OMB and Federal agencies will monitor the coverage of
indirect costs under Circular A-133 audits to determine whether additional guidance or subsequent revisions to the Circular are warranted. OMB may also consider if the coverage of indirect costs should be addressed separately from Circular A-133 audits in the future, possibly as separate engagements using the AICPA's attestation standards.

**Audit Cognizance**

Comment: One Federal auditor requested that OMB delay the effective date for the new method of determining the cognizant agency for audit for State and local governments because guidance relating to changing from one cognizant agency to another has not yet been provided. Another Federal auditor requested that the Circular name that agency as the cognizant agency for audit for every State based on the large amount of Federal funding provided by that Federal agency to States. Another Federal auditor opposed having one Federal agency responsible for audit cognizance for all States. Several State auditors and State agencies requested that they be permitted to retain their current cognizant agency for audit, and that they have input into future changes, if any, in audit cognizance.

Response: The primary reason for revising the approach to determining audit cognizance is to provide a straightforward method that can be used by the majority of auditees without the involvement of OMB. The previous policy whereby OMB was responsible for assigning audit cognizance did not work well, particularly for non-profit organizations. The proposed revision includes an approach whereby the auditee could readily determine its cognizant or oversight agency for audit based on which Federal agency provided the predominance of funding. However, several commenters noted that the proposal may have unintended consequences on some State and local governments that, under Circular A-128, were previously assigned cognizant agencies for audit by OMB in 1986 and have developed strong working relationships with their cognizant agencies.

In response to the comments received, the Circular was modified to reflect that current cognizant agency assignments shall continue in effect for States (including Indian tribal governments) and local governments that expend more than $25 million a year in Federal awards until fiscal years beginning after June 30, 2000. Thereafter, the method prescribed in § 400(a) shall be used by State and local governments for determining audit cognizance. This delay should provide sufficient time to smoothly transition from one Federal agency to another, or to request that OMB designate a specific cognizant agency for audit assignment, as circumstances warrant. However, for State and local governments that expend more than $25 million a year in Federal awards but do not have a currently assigned cognizant agency for audit, § 400(a) shall be used to determine audit cognizance upon the effective date of the Circular.

OMB expects to designate specific audit cognizance assignments for only a limited number of entities. However, if a change in audit cognizance is desired, then auditees are expected to first work through their Federal awarding agencies to obtain a reassignment. If the request cannot be adequately resolved among the Federal agencies, then the Federal agencies may contact OMB to resolve the matter. In response to several commenters, this process will permit auditees to be involved in future changes in audit cognizance.

The proposal indicates that, in instances in which OMB makes a specific cognizant agency for audit assignment, the assignment would be published in the Federal Register. OMB reconsidered the necessity of performing this procedure and removed this provision from the final Circular. However, when specific assignments are made by OMB, OMB will inform the parties involved (e.g., the auditee and the Federal agencies involved) of the assignment.

Comment: Several Federal agencies and numerous college and university commenters expressed strong concern that the cognizant agency determination included in Circular A-133 is not consistent with Circular A-21, "Cost Principles for Educational Institutions," and could result in an entity having one cognizant agency for audit purposes and another for indirect cost negotiation.

Response: No change was made as a result of these comments. Under Circular A-21, cost negotiation cognizance for the majority of colleges and universities is currently assigned to either the Department of Health and Human Services (HHS) or the Office of Naval Research (ONR) in the Department of Defense. OMB believes that it is unnecessary to require these two Federal agencies to also assume responsibility for audit cognizance for each of the colleges and universities for which they serve as cost negotiation cognizance. This additional responsibility for audit cognizance may impede HHS' or ONR's ability to fulfill their cost negotiation duties. Cost negotiation cognizance requires a high degree of specialized skills. However, any Federal agency is capable of performing audit cognizance duties. The responsibilities for audit cognizance (§ 400(a)) and indirect cost negotiation are different and, therefore, the same Federal agency need not be cognizant for both. While OMB expects that the Federal
agency responsible for audit cognizance and cost negotiation cognizance will be the same in many instances, when they are different, the Federal agencies involved will be expected to coordinate their efforts to avoid duplication and disruption to the auditee.

Comment: Clarification was requested by many commenters on how to determine the predominant amount of direct funding for purposes of determining the cognizant agency for audit. One Federal auditor questioned whether loans and loan guarantees should be considered in the calculation. Several college and university commenters expressed concern that the term "direct funding" could be misinterpreted to mean the amount of "awards," rather than "expenditures."

Response: No change was made as a result of these comments. The Circular states that the predominant amount of direct funding shall be based upon direct "Federal awards expended" in the recipient's fiscal year. § .205 of the final revision addresses the basis for determining the amount of Federal awards expended and specifically discusses the treatment of loans and loan guarantees. § .205 shall also be followed for purposes of determining the cognizant agency for audit.

Required Level of Internal Control Testing

Comment: Four State auditors and one CPA commenter opposed the proposed requirement for the auditor to plan the testing of internal control over major programs to support a low assessed level of control risk. One commenter stated that the Circular assumes that control risk is always either low or high and that it "does not recognize that control risk may be anywhere on a continuum from low to high (with "high" indicating ineffective control). When an auditor gains an understanding of an entity's internal control and determines that the controls are not ineffective, but are also not sufficient to support a low assessed level of control risk, then no amount of planning or testing will support a low assessed level of control risk." Two commenters recommended that OMB allow the assessment of control risk at a moderate level, unless internal control is determined to be ineffective.

Response: No change was made as a result of these comments. Many Federal agencies are concerned that not enough testing of internal control over major programs is performed as part of single audits. The President's Council on Integrity and Efficiency's (PCIE) "Study on Improving the Single Audit Process," issued in September 1993, highlighted the disparity between Federal agencies' expectations relating to the extent of internal control testing and the actual testing of internal control performed by auditors. The study identified the lack of clear requirements as a cause for this deficiency. The study recommended that the Circular "Require the auditor to plan the internal control testing to perform sufficient tests to support an assessed level of control risk of low for each program tested as major." OMB believes that the Circular clearly describes the Federal Government's expectations relating to the coverage of internal control under single audits, in terminology that is consistent with professional auditing standards.

It has been a longstanding Federal policy that the recipient of Federal funds is required to establish a system of internal control to provide reasonable assurance that it is managing Federal funds in compliance with applicable laws and regulations. Also, the 1996 Amendments (31 U.S.C. 7502(e)(3)) require the auditor to test controls unless they are deemed to be ineffective. Therefore, it is reasonable to require the auditor to plan the audit consistent with the level of internal control which the recipient of Federal funds is required to maintain. Also, the Circular permits the auditor to not test internal controls which are inadequate and, instead, disclose a reportable condition (including whether any such condition is a material weakness) and perform additional tests of compliance as necessary in the auditor's judgment.

Compliance Supplement

Comment: Several State auditors and CPA commenters stated that, while significant progress was made to improve the single audit process, it is critically important for OMB to move swiftly to issue a revised compliance supplement, which is needed to conduct single audits. They emphasized the importance of finalizing and publishing this document as quickly as possible to facilitate audits of fiscal years beginning after June 30, 1996 (i.e., the first audits to be conducted using the revised Circular).

Response: OMB agrees that the compliance supplement is vital to successful implementation. In response to these comments, OMB is including a provisional compliance supplement as Appendix B to the final revision to Circular A-133. It is being issued at this time in provisional form so that it can be used as part of the first audits conducted in accordance with the revised Circular A-133. However, the provisional status also provides interested parties with
the opportunity to comment on the document and permits OMB to include additional Federal programs in the
document in the coming months.

The provisional "Circular A-133 Compliance Supplement" is effective for audits of fiscal years beginning after June
30, 1996, and supersedes the previously issued compliance supplements entitled "Compliance Supplement for
Single Audits of State and Local Governments," issued in 1990, and "Compliance Supplement for Audits of
Institutions of Higher Learning and Other Non-Profit Institutions," issued in 1991. The definition of the term
"compliance supplement" in §attles.105 of the final revision was revised to reflect the compliance supplement
included as Appendix B to this revised Circular.

Comment: Several State auditors and one CPA requested removal of the requirement for the auditor to determine
the current compliance requirements when changes were made to the compliance requirements and the changes
are not yet reflected in the compliance supplement.

Response: No change was made as a result of these comments. However, minor modifications were made to
§attles.500(d) to conform the language used in the Circular to the compliance supplement.

The requirement in §attles.500(d)(3) for auditors to consider whether changes were made in the compliance
requirements included in the compliance supplement reflects current practice, which is based on two documents:
(1) the PCIE's Position Statement No. 6, titled "Questions and Answers on Circular A-133," and (2) the AICPA's

The PCIE document includes a statement that "If there have been changes [to the compliance requirements
included in the compliance supplement], then the auditor should follow the provisions of the compliance
supplements as modified by the changes" (page 14). The AICPA's Accounting and Auditing Guide (paragraph
23.37) alerts auditors to the fact that compliance requirements may change over time and that this should be
considered in planning tests of compliance. The provisional "Circular A-133 Compliance Supplement" provides
guidance to auditors regarding the Federal Government's expectations for auditors to perform reasonable
procedures (e.g., inquiry of auditee management, review of applicable contract and grant agreements) to
determine currency of the compliance requirements included in the compliance supplement.

Transitional Guidance to Implementing the Risk-Based Approach to Determining Major Programs

Comment: OMB received several inquiries about whether a Type A program may be considered low-risk when it
was audited as a major program in accordance with the prior Circular A-133, issued March 8, 1990, or Circular A-
128, issued April 12, 1985, and otherwise met the requirements in §allet.s.520(c) to be considered as low-risk. Similar
inquiries were received regarding whether single audits performed in accordance with the prior Circular A-133 or
Circular A-128 would satisfy the requirements of §allet.s.530 for an auditee to qualify as a low-risk auditee.

Response: The reference in §allet.s.520(c)(1) to the two most recent audit periods includes audit periods in which the
audit was performed under either Circular A-128 or the 1990 version of Circular A-133. Therefore, a Type A
program which meets the criteria for low-risk under §allet.s.520(c)(1), based on the results of an audit performed
under Circular A-128 or the 1990 version of Circular A-133, may be considered low-risk. Similarly, the requirement
in §allet.s.530 that an auditee meet specified criteria for the preceding two years to be considered a low-risk auditee
applies to audits performed under Circular A-128 or the 1990 version of Circular A-133.

Also, to provide a transition into the risk-based approach, the provision for deviation from use of risk criteria
provided in §allet.s.520(i) applies to the first year this revision is applicable and permits auditors to defer
implementation of the risk-based approach for one year.

Risk-Based Approach to Determining Major Programs

Comment: Several State auditors and one State agency requested clarification of the requirements for performing
risk assessments of Type B programs under §allet.s.520(d) and §allet.s.520(e). Many commenters questioned if the
Circular requires the auditor to perform annual risk assessments of each Type B program (above an amount
specified in the Circular) and expressed concern that such a requirement would significantly increase audit costs.

Response: Minor modifications were made to the Circular. Reference to the percentage of coverage rule was
removed from §allet.s.520(d)(2) of the final revision because, as two commenters noted, program risk is not a
consideration in selecting programs to meet the percentage of coverage rule described in \S\_\_\_\_.520(f). Also, editorial changes were made to \S\_\_\_\_.520(d)(2) to emphasize when risk assessments should be performed.

The final revision (\S\_\_\_\_.520(d)) requires the auditor to identify Type B programs that are high-risk and \S\_\_\_\_.520(e)(2) provides two options for identifying high-risk Type B programs.

Under Option 1, the auditor would be expected to perform risk assessments of all Type B programs that exceed the amount specified in \S\_\_\_\_.520(d)(2), and audit at least one half of these high-risk Type B programs as major, unless this number exceeds the number of low-risk Type A programs identified under \S\_\_\_\_.520(c) (i.e., the "cap"). In this case, the auditor would be required to audit as major the same number of high-risk Type B programs as the cap. For example, a State has ten low-risk Type A programs, and 50 Type B programs above the amount specified in \S\_\_\_\_.520(d)(2). Under Option 1, the auditor would be required to perform risk assessments of the 50 Type B programs. Assume that the auditor determines that there are 25 high-risk Type B programs. One half of the 25 high-risk Type B programs is 12.5, or 13, programs. Under Option 1, the auditor would audit 13 of the high-risk Type B programs; however, the cap in this example is ten (i.e., the number of low-risk Type A programs); therefore, the auditor is only required to audit as major 10 high-risk Type B programs.

Under Option 2, the auditor is only required to audit as major one high-risk Type B program for each Type A program identified as low-risk under \S\_\_\_\_.520(c). Under this option, the auditor would not be required to perform risk assessments for any Type B programs when there are no low-risk Type A programs (i.e., the cap is zero). Continuing with the previous example, under Option 2, the auditor would perform risk assessments of Type B programs until ten high-risk Type B programs are identified. The auditor would be required to audit ten high-risk Type B programs as major in this example. Depending on the order in which risk assessments on Type B programs are performed, the auditor might only need to perform risk assessments of ten Type B programs determined to be high-risk, or the auditor may need to perform risk assessments until ten high-risk programs are identified.

The auditor may choose either Option 1 or 2. There is no requirement to justify the reasons for selecting either option. The results under Options 1 and 2 may vary significantly, depending on the number of low-risk Type A programs and high-risk Type B programs. The auditor is encouraged to use an approach which provides an opportunity for different high-risk Type B programs to be audited as major over a period of time.

Comment: OMB received several inquiries about whether large loan and loan guarantee programs (that affect the determination of other Type A programs under \S\_\_\_\_.520(b)(3)) audited as major programs may be used for purposes of meeting the percentage of coverage rule (\S\_\_\_\_.520(f)).

Response: The amount of Federal awards expended under such loan and loan guarantee programs that are audited as major may be used for purposes of meeting the percentage of coverage rule. In a related matter, programs audited as major under \S\_\_\_\_.215(c), in which a Federal agency or pass-through entity requests and pays for a program to be audited as major, may also be used for purposes of meeting the percentage of coverage rule (\S\_\_\_\_.520(f)).

Comment: Several commenters questioned the difference in the number of days of advance notice a Federal agency shall provide an auditee when a particular program: (1) cannot be considered a low-risk Type A program (at least 120 days prior to the auditee's fiscal year end under \S\_\_\_\_.520(c)(2)), and (2) must be audited as major (at least 180 days prior to the auditee's fiscal year end under \S\_\_\_\_.215(c)).

Response: For consistency, a change was made to \S\_\_\_\_.520(c)(2) of the final revision to require a Federal agency to inform an auditee at least 180 days prior to the auditee's fiscal year end when a Federal program cannot be considered a low-risk Type A program.

Biennial Audits

Comment: All State auditors that commented on the proposal relating to biennial audits strongly opposed the provision included in \S\_\_\_\_.530(a) of the proposed revision that prohibits non-Federal entities that have biennial audits from qualifying as low-risk auditees. Commenters stated that this prohibition was not included in the 1996 Amendments and that the frequency of the audit has no bearing on the administration of Federal awards. One commenter suggested that, at a minimum, the cognizant or oversight agency for audit be authorized to permit, on a case-by-case basis, non-Federal entities that conduct biennial audits to qualify as low-risk auditees.
Response: A change was made to §____.530(a) to permit non-Federal entities to qualify, on a case-by-case basis, as low-risk auditees with the approval of the cognizant or oversight agency for audit. A change was also made to §____.400(a) of the final revision to add this responsibility to the list of cognizant agency for audit responsibilities.

Comment: One commenter inquired about the effective date of the Circular for biennial periods.

Response: The 1996 Amendments do not specifically address the effective dates for biennial audits. OMB interprets the 1996 Amendments to be effective for any biennial periods which begin after June 30, 1996. As with annual audits, the previously applicable Circulare are in effect until this final revision is effective. Therefore, an auditee that conducts biennial audits and has a biennial period beginning on or before June 30, 1996, should apply the provisions of Circular A-128 (for a State or local government) or Circular A-133, issued March 8, 1990 (for a non-profit organization), as applicable. The requirements of this Circular apply to any biennial periods beginning after June 30, 1996.

Credit Union Loans

Comment: OMB received inquiries about whether loans provided by the National Credit Union Administration (NCUA) should be considered Federal awards subject to the requirements of Circular A-133.

Response: A new paragraph (§____.205(j)) was added to the Circular to address certain loans provided by the NCUA. Specifically, loans made from the National Credit Union Share Insurance Fund and the Central Liquidity Facility are funded by contributions from insured institutions and are not considered Federal awards expended under Circular A-133. However, the NCUA provides loans under other programs, such as the Community Development Revolving Loan Programs for Credit Unions, which are considered Federal awards for purposes of applying Circular A-133.

Auditor Communication Regarding Report Distribution

Comment: Several commenters stated that, if the auditor prepares the data collection form, then the communication required by §____.500(f) of the proposed revision, whereby the auditor is required to notify the auditee of which Federal agencies and pass-through entities are required to receive a copy of the reporting package, will no longer be necessary.

Response: The proposed revision of Circular A-133 included a requirement for the auditor to communicate, preferably in writing, to the auditee which Federal awarding agencies and pass-through entities are required to receive a copy of the reporting package. This requirement was removed. This separate communication is unnecessary because the final Circular (§____.320(b)(3)) requires the auditor to prepare and sign the portion of the data collection form that identifies which Federal agencies are required to receive a copy of the reporting package.

Basis of Accounting

Comment: One State auditor requested that §____.310(a) and §____.500(b) of the Circular be revised to include a statement, similar to a provision (paragraph 2.4(a)) included in GAGAS, that “Financial statement audits also include audits of financial statements prepared in conformity with any of several other bases of accounting discussed in the auditing standards issued by the AICPA.” One Federal auditor requested that the Circular require the auditee to use the same basis of accounting in preparing the schedule of expenditures of Federal awards that is used to prepare the auditee's financial statements, and noted that this omission has resulted in significant unreconciled differences on the schedule of expenditures of Federal awards.

Response: No changes were made as a result of these comments. Circular A-133 does not prescribe the basis of accounting that must be used by auditees to prepare their financial statements and schedule of expenditures of Federal awards. However, auditees are required to disclose the basis of accounting and significant accounting policies used in preparing the financial statements and schedule of expenditures of Federal awards. The auditor is required to report (§____.500(b)) whether the financial statements are prepared in accordance with generally accepted accounting principles (GAAP), and whether the schedule of expenditures of Federal awards is presented fairly in all material respects in relation to the auditee's financial statements taken as a whole. The auditee must be able to reconcile amounts presented in the financial statements to related amounts included in the schedule of expenditures of Federal awards.
Financial Statements

Comment: Several CPAs commented that §____.310(a) of the Circular should be modified to recognize that financial statements should reflect the results of operations or changes in net assets. Financial statements prepared in accordance with GAAP for certain types of non-Federal entities reflect changes in net assets rather than results of operations. The commenters suggested that some auditees and auditors may interpret this section as imposing a requirement that is not consistent with GAAP.

Response: The Circular (§____.310(a)) was revised to state that financial statements should reflect either the results of operations or changes in net assets.

Comment: Several CPAs commented that the requirement included in §____.310(a) of the Circular that the financial statements shall be for the same organizational unit that is chosen to meet the requirements of the Circular, considered in conjunction with §____.500(a), could be problematic for certain auditees and may have unintended consequences. The commenters questioned whether an auditee, that chooses to meet the Circular’s requirements through a series of audits that cover separate departments, agencies, and other organizational units which expended Federal awards, would be required to issue non-GAAP financial statements that omitted the portions of the reporting entity which were separately audited. One commenter requested guidance in a situation where a local government has its school districts separately audited. If the local government’s financial statements exclude the school districts (which is what the commenters believe the Circular requires), then the auditor may need to issue a qualified or adverse opinion on the local government’s financial statements, which could raise unnecessary red flags and prohibit the auditee from qualifying as a low-risk auditee (§____.530). One State manager noted that considerably more public entities are included in that State’s financial statement audit than in its state-wide single audit, and that, if the Circular requires such entities to be included in the state-wide single audit, this would result in additional audit costs and complicate the audit process.

Response: §____.310(a) was revised to clarify OMB’s expectations in this area. The revised Circular provides non-Federal entities an option to meet the audit requirements of the Circular through a series of audits that cover the non-Federal entity’s departments, agencies, and other organizational units which expended or otherwise administered Federal awards during such fiscal year. If a non-Federal entity elects this option, then separate financial statements and a schedule of expenditures of Federal awards shall be prepared for each such department, agency, or other organizational unit. In these circumstances, a non-Federal entity’s organization-wide financial statements may also include departments, agencies, or other organizational units that have separate audits and prepare separate financial statements.

In the example provided by the commenter, it would be acceptable for the local government’s financial statements to include the school districts, even though the school districts were not included in the local government’s Circular A-133 audit because a separate Circular A-133 audit is conducted of the school districts. However, if separate financial statements were not prepared for the school districts, it would be unacceptable for a separate Circular A-133 audit to be conducted of the school districts (i.e., the local government’s organization-wide financial statements could not be used as a substitute for separate financial statements for the school districts).

Schedule of Expenditures of Federal Awards

Comment: One State auditor and one State manager commented that the Circular should not prescribe requirements for the schedule of expenditures of Federal awards beyond the current guidance.

Response: The “current guidance” for presenting the schedule of expenditures of Federal awards information was developed and promulgated by the AICPA, and was not specifically prescribed in Circulars A-128 and A-133 (1990 original issuance). OMB believes that the minimum requirements for the schedule should be specified in the Circular (§____.310(b)). Most respondents to the April 1996 revision of Circular A-133 supported the level of detail reflected in that revision. A few modifications of the requirements were made in this final revision of Circular A-133, in response to specific comments received, as described in the following sections.

Comment: Several CPAs and one State auditor commented that the Circular requires the auditor to be responsible for determining major programs and the threshold used to distinguish between Type A and Type B programs. However, these items are required to be presented in the schedule of expenditures of Federal awards prepared by
the auditee and this requirement may blur the distinction between information that is the responsibility of the auditor versus the auditee.

Response: The proposed requirements for the schedule of expenditures of Federal awards to identify major programs and identify the threshold to distinguish between Type A and Type B programs (§____.310(b)(3) and (b)(4) of the proposed revision) were removed. However, the requirement to report this information was added to §____.505(d) so that this information is now required to be included in the auditor's report(s). While not required, some auditees may find it useful to present this information in the schedule of expenditures of Federal awards.

Comment: Several CPAs recommended that the value of non-cash assistance, insurance in effect, and loans and loan guarantees outstanding be required to be included in the schedule of expenditures of Federal awards. They stated that the option to present this information in a note to the schedule should be eliminated and that the consistency achieved will improve the usefulness of the schedule and facilitate OMB's data collection efforts. One college and university commenter stated that the requirement to provide this information (either in a note or in the schedule) was excessive, and that the same information could be obtained from existing Federal data banks.

Response: A change was made to §____.310(b)(6) as a result of these comments. The Circular permits the option of presenting this information either in the schedule of expenditures of Federal awards or in a note to the schedule; however, an additional sentence was included indicating that it is preferable to present this information in the schedule. It is important to note that, regardless of whether this information is presented in a note or in the schedule, this information must be included in the data collection form. While the requirement to provide such information is not new, the Federal Government does not currently collect and account for this information in a systematic manner or data bank (i.e., some Federal agencies track this information and others do not). A minor addition was made to _____.310(b)(6) to clarify that the amount of insurance in effect during the year should be disclosed.

Report Due Date

Comment: Two Federal auditors commented that the requirement included in the 1996 Amendments to submit the reporting package to the Federal clearinghouse "within the earlier of: 30 days after receipt of the auditor's report(s), or ... " is not clearly specified in the proposed revision.

Response: §____.235(c) and §____.320(a) were modified to incorporate the report due date requirements specified in the 1996 Amendments.

Summary Schedule of Prior Audit Findings

Comment: Several State auditors requested guidance on the auditor's responsibility for deficiencies noted in prior audit findings for which a management decision was not issued and which the auditee believes is no longer valid. Specifically, the commenters asked whether the lack of a timely management decision is evidence that the Federal awarding agency or pass-through entity is not concerned about the finding and whether future audits may exclude coverage of the deficiency that resulted in an audit finding. One State auditor also commented that auditees should not be given the authority to determine when an audit finding is no longer valid or does not warrant further action.

Response: §____.315(b) permits an auditee to determine whether a prior audit finding is no longer valid or does not warrant further action. A valid reason for such a determination is that all of the following have occurred: (1) two years have passed since the audit report in which the finding occurred was submitted to the Federal clearinghouse, (2) the Federal agency or pass-through entity is not currently following up with the auditee on the audit finding, and (3) a management decision was not issued. OMB believes that it is appropriate for the auditee to make this determination. In addition, the auditor is required by §____.500(e) of the Circular to assess the fairness of management's representations in the schedule.

The lack of a management decision for a prior audit finding may provide a basis for the auditee to indicate in the summary schedule of prior audit findings that the finding is no longer valid or does not warrant further action (provided the two other conditions previously listed are met). However, the lack of a management decision does not change the scope of audit work or the auditor's reporting requirements. As an example, if the same deficiency that resulted in a prior audit finding (for which a management decision was not issued) is discovered by the auditor in the current period, the auditor would be required to determine whether the matter met the criteria provided in §____.510(a) for reporting an audit finding in the auditor's schedule of findings and questioned costs.
For the first year a non-Federal entity is audited under this revised Circular, the prior year report may not have included the equivalent of a summary schedule of prior audit findings. In these cases, the auditee may exercise judgment and only include, to the extent practical, audit findings from before the prior year. Also, the auditee is not expected to include prior findings that would not have been reported under the criteria provided in §___.510(a).

**Auditor's Schedule of Findings and Questioned Costs**

Comment: Several State auditors and CPA commenters noted that GAGAS does not use the term "findings and questioned costs," and the concept of questioned costs is not discussed in GAGAS. Commenters requested that OMB clarify the requirement included in §___.505(d)(2) of the proposed revision.

Response: A change was made to §___.505(d)(2) to replace the term "findings and questioned costs" with "findings" so that the final revision requires the auditor's schedule of findings and questioned costs to include a section that reports any findings relating to the financial statements which are required to be reported in accordance with GAGAS.

Comment: One State auditor requested that §___.505(a) of the proposed revision be revised to permit unqualified opinions on financial statements prepared in accordance with an other comprehensive basis of accounting.

Response: No change was made as a result of this comment. The 1996 Amendments (31 U.S.C. 7502(e)(1)) require the auditor to "... determine whether the financial statements are presented fairly in all material respects in conformity with generally accepted accounting principles." However, it should be noted that neither the 1996 Amendments nor Circular A-133 prescribe the basis of accounting that must be used by auditees to prepare their financial statements and schedule of expenditures of Federal awards (i.e., non-GAAP statements are acceptable).

Comment: Two CPAs indicated that the reference to §___.505(d)(2) and (3) that was included in §___.505(d)(3)(ii) of the proposed revision is confusing because it refers to certain schedules that are supposed to be included as part of the schedule of findings and questioned costs.

Response: A change was made to §___.505(d)(3)(ii) to reflect that the schedule of findings and questioned costs is comprised of several sections, rather than multiple schedules.

**Audit Findings**

Comment: Several Federal auditors, State auditors, and CPAs commented on the requirement included in §___.510(a) and (2) of the proposed revision that, for reporting purposes, audit findings must be evaluated in relation to a "type of compliance requirement" for a major program or an audit objective identified in the compliance supplement. Some commenters opposed requiring the evaluation of an audit finding in relation to an audit objective because they believe this to be a more constrictive requirement than the currently-used measurement standard, and others requested clarification of the requirement. Two commenters suggested that OMB revise this requirement to allow the auditor to make the determination of reportable conditions and material noncompliance based on the significance of the compliance requirement and the effect on the program as a whole.

Response: No change was made as a result of these comments. The scope of the auditor's work described in §___.500(c) and (d) is required at the major program level. However, for audit reporting purposes, the results of the auditor's work must be evaluated against a lower measure. Specifically, the revised Circular requires the auditor to consider an audit finding in relation to a type of compliance requirement for a major program or an audit objective identified in the compliance supplement. The types of compliance requirements and related audit objectives are included in the provisional "Circular A-133 Compliance Supplement." The auditor is expected to determine the types of compliance requirements that could have a direct and material effect on each major program, and to design and conduct tests necessary to render an opinion on compliance with respect to each major program. Clearly, auditor judgment must be used in determining the nature, timing, and extent of audit work to be performed, and in evaluating the audit results. The purpose of the requirement included in §___.510(a)(1) and (2) is to advise the auditor of the criteria against which to measure or evaluate the impact of findings for reporting purposes.

It is important to note that, under the existing requirements of Circular A-128, the auditor is required to report all instances of noncompliance and, under the 1990 version of Circular A-133, the auditor is required to report all but
Comment: Several commenters requested clarification of the requirement in §___.510(a)(3) of the proposed revision to report as an audit finding known questioned costs which are greater than $10,000 for a type of compliance requirement, particularly with respect to determining the impact of multiple instances of noncompliance relating to a type of compliance requirement.

Response: No change was made as a result of these comments. However, the following example is provided to illustrate the requirements of this provision. Suppose an auditor: (1) determines that eligibility (which is one of the types of compliance requirements listed in the compliance supplement) could have a direct and material effect on a major program; (2) designs and conducts tests over eligibility relative to this major program; and, (3) discovers two separate instances of noncompliance, in the amount of $9000 each, relating to eligibility. The findings involve two different audit objectives relating to eligibility (which are listed in the compliance supplement): one finding relates to an individual participant's eligibility, and the other finding relates to the eligibility of a subrecipient. Since §___.510(a)(3) requires the auditor to report known questioned costs which are greater than $10,000 for a type of compliance requirement (which is eligibility in this case), the auditor would be expected to report these questioned costs of $18,000 as an audit finding. The auditor would also be expected to consider the impact of these instances of noncompliance when reporting on compliance on each major program.

Comment: Some Federal agencies strongly object to not requiring known questioned costs of $10,000 or less to be reported. Conversely, one State auditor commented that the requirement to report known questioned costs greater than $10,000 could result in auditors' reporting matters that are minimal in relation to the size of a particular Federal program (e.g., a very large State program in which questioned costs of $11,000 is considered immaterial).

Response: No change was made as a result of these comments. OMB believes that the $10,000 threshold for reporting questioned costs provides an appropriate balance between reporting all questioned costs (which was previously required for State and local governments) and only reporting substantial questioned costs.

Comment: One Federal auditor requested that OMB require auditors to report an estimate of likely questioned costs when a known or likely questioned cost exceeds $10,000. The commenter stated that capturing the amount of likely questioned costs should better enable Federal agencies to assess the nature and magnitude of questioned costs on particular Federal awards and assist in prioritizing the resolution of audit findings. The commenter also suggested that OMB encourage auditors to use statistical means to determine likely questioned costs.

Response: No change was made as a result of this comment. §___.510(a)(3) requires the auditor to report known questioned costs which are greater than $10,000, and known questioned costs when likely questioned costs are greater than $10,000, for a type of compliance requirement. GAAS require the auditor to project the amount of known questioned costs identified in a sample to the items in the major program and to consider the best estimate of total questioned costs (both known and likely) in determining an opinion on compliance. The auditor is required to document this consideration in the audit working papers.

The revised Circular does not require the auditor to report an exact amount or statistical projection of likely questioned costs, but rather to include an audit finding when the auditor’s extrapolation of these likely questioned costs is greater than $10,000. In reporting likely questioned costs, it is important that the auditor follows the requirements of §___.510(b) and provides appropriate information for judging the prevalence and consequences of the finding. The use of statistical means of determining likely questioned costs may be beneficial for auditors but it is not required. During the next few years, OMB expects Federal agencies to monitor auditor compliance in this area to assist OMB in determining whether an expansion of these reporting requirements is necessary in subsequent revisions.

Comment: Two CPA commenters requested guidance regarding the treatment of audit findings that cannot be quantified. The commenters cited as an example a situation where an auditor discovers that a pass-through entity consistently failed to provide its subrecipients with Federal award information, including applicable compliance requirements. The commenters stated that §___.510(a)(3) could be read to indicate that such nonmonetary findings would not need to be reported.

Response: No change was made as a result of these comments. In the example provided by the commenters, this noncompliance would be required to be reported as an audit finding. The auditor must consider a finding in relation
Audit Follow-up

Comment: Several commenters requested guidance on whether the auditor is required to follow up on all prior findings, particularly immaterial amounts that were previously required to be reported. Two commenters opposed the requirement for audit follow-up on prior audit findings, even when a finding is unrelated to a major program in the current year.

Response: In the first year audited under the revised Circular, the auditor should use judgment in deciding which previously reported findings require follow-up in the current year. Auditors are not expected to follow up on prior year findings that are immaterial. The auditor should consider the criteria for reporting audit findings, provided in §___.510(a), in determining which prior audit findings require follow-up.

No change was made to §___.500(e), which requires the auditor to perform follow-up procedures regardless of whether a prior audit finding relates to a major program in the current year. This requirement is consistent with the requirement for management to report on the status of prior findings in the summary schedule of prior audit findings.

Auditor Selection

Comment: Two State auditors requested a change to recognize that some auditees (e.g., State and local governments) do not have the constitutional or legal authority to arrange for audit services.

Response: A clarification was made to §___.305(a) to indicate that, in procuring (rather than arranging for) audit services, auditees shall follow the provisions described in §___.305(a). If an auditee is not authorized to procure audit services (e.g., State law may require that a State auditor perform all required audits for that State), then the provisions of §___.305(a) do not apply.

Comment: One State agency and one CPA commenter did not support the restriction on auditors that perform Circular A-133 audits and also prepare indirect cost proposal or CAPs. These commenters stated that the AICPA's professional standards adequately address auditor independence.

Response: No change was made as a result of these comments. §___.305(b) precludes the same auditor from preparing the indirect cost proposal or CAP when indirect costs exceeded $1 million in the prior year. This restriction was developed based on comments relating to April 1996 revision of Circular A-133, in which all Federal agencies that responded cited at least an appearance of a lack of independence when the same auditor both performed the audit and prepared the indirect cost proposal or CAP. The $1 million threshold was chosen to limit this restriction to a relatively small number of entities, while still protecting the Federal interest.

The implementation date for this provision is delayed two years until audits of fiscal years beginning after June 30, 1998, to minimize any effect this provision could have on existing contracts for audit services. In the future, OMB and Federal agencies will monitor this area to determine whether additional guidance or further revision to the Circular is necessary.

Federal Awarding Agency Responsibilities

Comment: A commenter noted that the Circular does not list as a responsibility of Federal awarding agencies the requirement included in the 1996 Amendments (31 U.S.C. 7502(f)(1)(A)) to inform recipients of the Federal requirements imposed on them by Federal laws, regulations, and the provisions of contracts or grant agreements.
Response: A change was made to add this responsibility to the list included in §____400(c) of the revised Circular.

Request for a Program to be Audited as a Major Program

Comment: Two State auditors opposed the provision included in §____.215(c) in which a Federal agency or pass-through entity may request for a program to be audited as a major program. Reasons cited include: (1) that Federal agencies might use this provision excessively, and (2) that specifying programs to be audited as major is contrary to the risk-based approach to determining major programs.

Response: No changes were made to the Circular as a result of these comments. This process does not significantly change the authority Federal agencies and pass-through entities now have to perform additional audits as long as they pay for them. These audits may be incorporated within the framework of the single audit and thereby eliminate duplicative audit planning and reporting. Since the Federal agency or pass-through entity must still pay the full incremental audit cost, OMB does not expect a significant increase in major programs from this provision.

It should be pointed out that any Type A program selected to be audited under this provision must be low-risk. If it were not low-risk, it would have been audited as a major program under the risk-based approach. Therefore, this provision will not reduce the number of high-risk Type B programs audited as major. Also, programs audited as major under this process count towards meeting the percentage of coverage rule provided in §____.520(f).

Management Decisions

Comment: Several State auditors expressed concern about the provision permitting Federal agencies and pass-through entities, prior to issuing a management decision, to request additional information or documentation from an auditee, including a request that the documentation be audited, as a way of mitigating disallowed costs. Two CPAs requested that the term "audit" be replaced by "auditor assurance" for clarity.

Response: A minor change was made to §____.405(a) to clarify that the request is for auditor assurance relating to the specified documentation. OMB also expects Federal agencies and pass-through entities to use this provision judiciously.

Comment: One State auditor commented that it would be beneficial if auditors could obtain copies of management decisions and suggested that the Federal Government establish a centralized contact from which auditors could request copies.

Response: In the next few years, OMB will consider this and other suggestions to improve the dissemination of management decision information.

Audit Working Papers

Comment: Several auditors requested that the Circular reflect the wording included in the 1996 Amendments (31 U.S.C. 7503(f)) that indicates the purpose for which access to working papers is intended.

Response: A change was made to §____.515(b) to reflect wording similar to the 1996 Amendments relating to this matter.

Additional OMB Guidance

Comment: Several commenters requested additional information about various provisions in the proposed revision and asked whether OMB will publish a "questions and answers" document as implementation issues arise.

Response: Interested parties may wish to refer to the April 30, 1996 (61 FR 19134) and November 5, 1996 (61 FR 57232) Federal Registers for discussion of various provisions included in the Circular. Useful information is provided in these Notices that is not necessarily repeated in this Notice. In the future, if there are significant questions concerning the revised Circular A-133, OMB will consider issuing a "questions and answers" document relating to the revised Circular.

Franklin D. Raines, Director
Circular No. A-133 - Revised June 24, 1997
Audits of States, Local Governments, and Non-Profit Organizations

TO THE HEADS OF EXECUTIVE DEPARTMENTS AND ESTABLISHMENTS

SUBJECT: Audits of States, Local Governments, and Non-Profit Organizations


2. Authority. Circular A-133 is issued under the authority of sections 503, 1111, and 7501 et seq. of title 31, United States Code, and Executive Orders 8248 and 11541.


4. Policy. Except as provided herein, the standards set forth in this Circular shall be applied by all Federal agencies. If any statute specifically prescribes policies or specific requirements that differ from the standards provided herein, the provisions of the subsequent statute shall govern.

Federal agencies shall apply the provisions of the sections of this Circular to non-Federal entities, whether they are recipients expending Federal awards received directly from Federal awarding agencies, or are subrecipients expending Federal awards received from a pass-through entity (a recipient or another subrecipient).

This Circular does not apply to non-U.S. based entities expending Federal awards received either directly as a recipient or indirectly as a subrecipient.

5. Definitions. The definitions of key terms used in this Circular are contained in §___105 in the Attachment to this Circular.

6. Required Action. The specific requirements and responsibilities of Federal agencies and non-Federal entities are set forth in the Attachment to this Circular. Federal agencies making awards to non-Federal entities, either directly or indirectly, shall adopt the language in the Circular in codified regulations as provided in Section 10 (below), unless different provisions are required by Federal statute or are approved by the Office of Management and Budget (OMB).

7. OMB Responsibilities. OMB will review Federal agency regulations and implementation of this Circular, and will provide interpretations of policy requirements and assistance to ensure uniform, effective and efficient implementation.


9. Review Date. This Circular will have a policy review three years from the date of issuance.

10. Effective Dates. The standards set forth in §___400 of the Attachment to this Circular, which apply directly to Federal agencies, shall be effective July 1, 1996, and shall apply to audits of fiscal years beginning after June 30, 1996, except as otherwise specified in §___400(a).

The standards set forth in this Circular that Federal agencies shall apply to non-Federal entities shall be adopted by Federal agencies in codified regulations not later than 60 days after publication of this final revision in the Federal
Register, so that they will apply to audits of fiscal years beginning after June 30, 1996, with the exception that §_.305(b) of the Attachment applies to audits of fiscal years beginning after June 30, 1998. The requirements of Circular A-128, although the Circular is rescinded, and the 1990 version of Circular A-133 remain in effect for audits of fiscal years beginning on or before June 30, 1996.

Franklin D. Raines
Director

Attachment

PART __ --AUDITS OF STATES, LOCAL GOVERNMENTS, AND NON-PROFIT ORGANIZATIONS

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Appendix A to Part __ - Data Collection Form (Form SF-SAC).

Appendix B to Part __ - Circular A-133 Compliance Supplement.
Subpart A--General

§___.100 Purpose.
This part sets forth standards for obtaining consistency and uniformity among Federal agencies for the audit of non-Federal entities expending Federal awards.

§___.105 Definitions.
Auditee means any non-Federal entity that expends Federal awards which must be audited under this part. Auditor means an auditor, that is a public accountant or a Federal, State or local government audit organization, which meets the general standards specified in generally accepted government auditing standards (GAGAS). The term auditor does not include internal auditors of non-profit organizations.

Audit finding means deficiencies which the auditor is required by §___.510(a) to report in the schedule of findings and questioned costs.

CFDA number means the number assigned to a Federal program in the Catalog of Federal Domestic Assistance (CFDA).

Cluster of programs means a grouping of closely related programs that share common compliance requirements. The types of clusters of programs are research and development (R&D), student financial aid (SFA), and other clusters. Other clusters are as defined by the Office of Management and Budget (OMB) in the compliance supplement or as designated by a State for Federal awards the State provides to its subrecipients that meet the definition of a cluster of programs. When designating an "other cluster," a State shall identify the Federal awards included in the cluster and advise the subrecipients of compliance requirements applicable to the cluster, consistent with §___.400(d)(1) and §___.400(d)(2), respectively. A cluster of programs shall be considered as one program for determining major programs, as described in §___.520, and, with the exception of R&D as described in §___.200(c), whether a program-specific audit may be elected.

Cognizant agency for audit means the Federal agency designated to carry out the responsibilities described in §___.400(a).

Compliance supplement refers to the Circular A-133 Compliance Supplement, included as Appendix B to Circular A-133, or such documents as OMB or its designee may issue to replace it. This document is available from the Government Printing Office, Superintendent of Documents, Washington, DC 20402-9325.

Corrective action means action taken by the auditee that:

(1) Corrects identified deficiencies;

(2) Produces recommended improvements; or

(3) Demonstrates that audit findings are either invalid or do not warrant auditee action.

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

Federal award means Federal financial assistance and Federal cost-reimbursement contracts that non-Federal entities receive directly from Federal awarding agencies or indirectly from pass-through entities. It does not include procurement contracts, under grants or contracts, used to buy goods or services from vendors. Any audits of such vendors shall be covered by the terms and conditions of the contract. Contracts to operate Federal Government owned, contractor operated facilities (GOCOs) are excluded from the requirements of this part.

Federal awarding agency means the Federal agency that provides an award directly to the recipient.

Federal financial assistance means assistance that non-Federal entities receive or administer in the form of grants, loans, loan guarantees, property (including donated surplus property), cooperative agreements, interest subsidies, insurance, food commodities, direct appropriations, and other assistance, but does not include amounts received as reimbursement for services rendered to individuals as described in §___.205(h) and §___.205(i).
Federal program means:

(1) All Federal awards to a non-Federal entity assigned a single number in the CFDA.

(2) When no CFDA number is assigned, all Federal awards from the same agency made for the same purpose should be combined and considered one program.

(3) Notwithstanding paragraphs (1) and (2) of this definition, a cluster of programs. The types of clusters of programs are:

(i) Research and development (R&D);

(ii) Student financial aid (SFA); and

(iii) "Other clusters," as described in the definition of cluster of programs in this section.

GAGAS means generally accepted government auditing standards issued by the Comptroller General of the United States, which are applicable to financial audits.

Generally accepted accounting principles has the meaning specified in generally accepted auditing standards issued by the American Institute of Certified Public Accountants (AICPA).

Indian tribe means any Indian tribe, band, nation, or other organized group or community, including any Alaskan Native village or regional or village corporation (as defined in, or established under, the Alaskan Native Claims Settlement Act) that is recognized by the United States as eligible for the special programs and services provided by the United States to Indians because of their status as Indians.

Internal control means a process, effected by an entity's management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

(1) Effectiveness and efficiency of operations;

(2) Reliability of financial reporting; and

(3) Compliance with applicable laws and regulations.

Internal control pertaining to the compliance requirements for Federal programs (Internal control over Federal programs) means a process—effected by an entity's management and other personnel—designed to provide reasonable assurance regarding the achievement of the following objectives for Federal programs:

(1) Transactions are properly recorded and accounted for to:

   (i) Permit the preparation of reliable financial statements and Federal reports;

   (ii) Maintain accountability over assets; and

   (iii) Demonstrate compliance with laws, regulations, and other compliance requirements;

(2) Transactions are executed in compliance with:

   (i) Laws, regulations, and the provisions of contracts or grant agreements that could have a direct and material effect on a Federal program; and

   (ii) Any other laws and regulations that are identified in the compliance supplement; and

(3) Funds, property, and other assets are safeguarded against loss from unauthorized use or disposition.

Loan means a Federal loan or loan guarantee received or administered by a non-Federal entity.
Local government means any unit of local government within a State, including a county, borough, municipality, city, town, township, parish, local public authority, special district, school district, intrastate district, council of governments, and any other instrumentality of local government.

Major program means a Federal program determined by the auditor to be a major program in accordance with § .520 or a program identified as a major program by a Federal agency or pass-through entity in accordance with § .215(c).

Management decision means the evaluation by the Federal awarding agency or pass-through entity of the audit findings and corrective action plan and the issuance of a written decision as to what corrective action is necessary.

Non-Federal entity means a State, local government, or non-profit organization.

Non-profit organization means:

(1) any corporation, trust, association, cooperative, or other organization that:

(i) Is operated primarily for scientific, educational, service, charitable, or similar purposes in the public interest;

(ii) Is not organized primarily for profit; and

(iii) Uses its net proceeds to maintain, improve, or expand its operations; and

(2) The term non-profit organization includes non-profit institutions of higher education and hospitals.

OMB means the Executive Office of the President, Office of Management and Budget.

Oversight agency for audit means the Federal awarding agency that provides the predominant amount of direct funding to a recipient not assigned a cognizant agency for audit. When there is no direct funding, the Federal agency with the predominant indirect funding shall assume the oversight responsibilities. The duties of the oversight agency for audit are described in § .400(b).

Pass-through entity means a non-Federal entity that provides a Federal award to a subrecipient to carry out a Federal program.

Program-specific audit means an audit of one Federal program as provided for in § .200(c) and § .235.

Questioned cost means a cost that is questioned by the auditor because of an audit finding:

(1) Which resulted from a violation or possible violation of a provision of a law, regulation, contract, grant, cooperative agreement, or other agreement or document governing the use of Federal funds, including funds used to match Federal funds;

(2) Where the costs, at the time of the audit, are not supported by adequate documentation; or

(3) Where the costs incurred appear unreasonable and do not reflect the actions a prudent person would take in the circumstances.

Recipient means a non-Federal entity that expends Federal awards received directly from a Federal awarding agency to carry out a Federal program.

Research and development (R&D) means all research activities, both basic and applied, and all development activities that are performed by a non-Federal entity. Research is defined as a systematic study directed toward fuller scientific knowledge or understanding of the subject studied. The term research also includes activities involving the training of individuals in research techniques where such activities utilize the same facilities as other research and development activities and where such activities are not included in the instruction function. Development is the systematic use of knowledge and understanding gained from research directed toward the production of useful materials, devices, systems, or methods, including design and development of prototypes and processes.
Single audit means an audit which includes both the entity’s financial statements and the Federal awards as described in §133.500.

State means any State of the United States, the District of Columbia, the Commonwealth of Puerto Rico, the Virgin Islands, Guam, American Samoa, the Commonwealth of the Northern Mariana Islands, and the Trust Territory of the Pacific Islands, any instrumentality thereof, any multi-State, regional, or interstate entity which has governmental functions, and any Indian tribe as defined in this section.

Student Financial Aid (SFA) includes those programs of general student assistance, such as those authorized by Title IV of the Higher Education Act of 1965, as amended, (20 U.S.C. 1070 et seq.) which is administered by the U.S. Department of Education, and similar programs provided by other Federal agencies. It does not include programs which provide fellowships or similar Federal awards to students on a competitive basis, or for specified studies or research.

Subrecipient means a non-Federal entity that expends Federal awards received from a pass-through entity to carry out a Federal program, but does not include an individual that is a beneficiary of such a program. A subrecipient may also be a recipient of other Federal awards directly from a Federal awarding agency. Guidance on distinguishing between a subrecipient and a vendor is provided in §133.210.

Types of compliance requirements refers to the types of compliance requirements listed in the compliance supplement. Examples include: activities allowed or unallowed; allowable costs/cost principles; cash management; eligibility; matching, level of effort, earmarking; and, reporting.

Vendor means a dealer, distributor, merchant, or other seller providing goods or services that are required for the conduct of a Federal program. These goods or services may be for an organization's own use or for the use of beneficiaries of the Federal program. Additional guidance on distinguishing between a subrecipient and a vendor is provided in §133.210.

Subpart B--Audits

§133.200 Audit requirements.

(a) Audit required. Non-Federal entities that expend $300,000 or more in a year in Federal awards shall have a single or program-specific audit conducted for that year in accordance with the provisions of this part. Guidance on determining Federal awards expended is provided in §133.205.

(b) Single audit. Non-Federal entities that expend $300,000 or more in a year in Federal awards shall have a single audit conducted in accordance with §133.500 except when they elect to have a program-specific audit conducted in accordance with paragraph (c) of this section.

(c) Program-specific audit election. When an auditee expends Federal awards under only one Federal program (excluding R&D) and the Federal program's laws, regulations, or grant agreements do not require a financial statement audit of the auditee, the auditee may elect to have a program-specific audit conducted in accordance with §133.235. A program-specific audit may not be elected for R&D unless all of the Federal awards expended were received from the same Federal agency, or the same Federal agency and the same pass-through entity, and that Federal agency, or pass-through entity in the case of a subrecipient, approves in advance a program-specific audit.

(d) Exemption when Federal awards expended are less than $300,000. Non-Federal entities that expend less than $300,000 a year in Federal awards are exempt from Federal audit requirements for that year, except as noted in §133.215(a), but records must be available for review or audit by appropriate officials of the Federal agency, pass-through entity, and General Accounting Office (GAO).

(e) Federally Funded Research and Development Centers (FFRDC). Management of an auditee that owns or operates a FFRDC may elect to treat the FFRDC as a separate entity for purposes of this part.
§ 205 Basis for determining Federal awards expended.

(a) Determining Federal awards expended. The determination of when an award is expended should be based on when the activity related to the award occurs. Generally, the activity pertains to events that require the non-Federal entity to comply with laws, regulations, and the provisions of contracts or grant agreements, such as: expenditure/expense transactions associated with grants, cost-reimbursement contracts, cooperative agreements, and direct appropriations; the disbursement of funds passed through to subrecipients; the use of loan proceeds under loan and loan guarantee programs; the receipt of property; the receipt of surplus property; the receipt or use of program income; the distribution or consumption of food commodities; the disbursement of amounts entitling the non-Federal entity to an interest subsidy; and, the period when insurance is in force.

(b) Loan and loan guarantees (loans). Since the Federal Government is at risk for loans until the debt is repaid, the following guidelines shall be used to calculate the value of Federal awards expended under loan programs, except as noted in paragraphs (c) and (d) of this section:

(1) Value of new loans made or received during the fiscal year; plus

(2) Balance of loans from previous years for which the Federal Government imposes continuing compliance requirements; plus

(3) Any interest subsidy, cash, or administrative cost allowance received.

(c) Loan and loan guarantees (loans) at institutions of higher education. When loans are made to students of an institution of higher education but the institution does not make the loans, then only the value of loans made during the year shall be considered Federal awards expended in that year. The balance of loans for previous years is not included as Federal awards expended because the lender accounts for the prior balances.

(d) Prior loan and loan guarantees (loans). Loans, the proceeds of which were received and expended in prior-years, are not considered Federal awards expended under this part when the laws, regulations, and the provisions of contracts or grant agreements pertaining to such loans impose no continuing compliance requirements other than to repay the loans.

(e) Endowment funds. The cumulative balance of Federal awards for endowment funds which are federally restricted are considered awards expended in each year in which the funds are still restricted.

(f) Free rent. Free rent received by itself is not considered a Federal award expended under this part. However, free rent received as part of an award to carry out a Federal program shall be included in determining Federal awards expended and subject to audit under this part.

(g) Valuing non-cash assistance. Federal non-cash assistance, such as free rent, food stamps, food commodities, donated property, or donated surplus property, shall be valued at fair market value at the time of receipt or the assessed value provided by the Federal agency.

(h) Medicare. Medicare payments to a non-Federal entity for providing patient care services to Medicare eligible individuals are not considered Federal awards expended under this part.

(i) Medicaid. Medicaid payments to a subrecipient for providing patient care services to Medicaid eligible individuals are not considered Federal awards expended under this part unless a State requires the funds to be treated as Federal awards expended because reimbursement is on a cost-reimbursement basis.

(j) Certain loans provided by the National Credit Union Administration. For purposes of this part, loans made from the National Credit Union Share Insurance Fund and the Central Liquidity Facility that are funded by contributions from insured institutions are not considered Federal awards expended.

§ 210 Subrecipient and vendor determinations.

(a) General. An auditee may be a recipient, a subrecipient, and a vendor. Federal awards expended as a recipient or a subrecipient would be subject to audit under this part. The payments received for goods or services provided as a vendor would not be considered Federal awards. The guidance in paragraphs (b) and (c) of this
section should be considered in determining whether payments constitute a Federal award or a payment for goods and services.

(b) Federal award. Characteristics indicative of a Federal award received by a subrecipient are when the organization:

1. Determines who is eligible to receive what Federal financial assistance;
2. Has its performance measured against whether the objectives of the Federal program are met;
3. Has responsibility for programmatic decision making;
4. Has responsibility for adherence to applicable Federal program compliance requirements; and
5. Uses the Federal funds to carry out a program of the organization as compared to providing goods or services for a program of the pass-through entity.

(c) Payment for goods and services. Characteristics indicative of a payment for goods and services received by a vendor are when the organization:

1. Provides the goods and services within normal business operations;
2. Provides similar goods or services to many different purchasers;
3. Operates in a competitive environment;
4. Provides goods or services that are ancillary to the operation of the Federal program; and
5. Is not subject to compliance requirements of the Federal program.

(d) Use of judgment in making determination. There may be unusual circumstances or exceptions to the listed characteristics. In making the determination of whether a subrecipient or vendor relationship exists, the substance of the relationship is more important than the form of the agreement. It is not expected that all of the characteristics will be present and judgment should be used in determining whether an entity is a subrecipient or vendor.

(e) For-profit subrecipient. Since this part does not apply to for-profit subrecipients, the pass-through entity is responsible for establishing requirements, as necessary, to ensure compliance by for-profit subrecipients. The contract with the for-profit subrecipient should describe applicable compliance requirements and the for-profit subrecipient's compliance responsibility. Methods to ensure compliance for Federal awards made to for-profit subrecipients may include pre-award audits, monitoring during the contract, and post-award audits.

(f) Compliance responsibility for vendors. In most cases, the auditee's compliance responsibility for vendors is only to ensure that the procurement, receipt, and payment for goods and services comply with laws, regulations, and the provisions of contracts or grant agreements. Program compliance requirements normally do not pass through to vendors. However, the auditee is responsible for ensuring compliance for vendor transactions which are structured such that the vendor is responsible for program compliance or the vendor's records must be reviewed to determine program compliance. Also, when these vendor transactions relate to a major program, the scope of the audit shall include determining whether these transactions are in compliance with laws, regulations, and the provisions of contracts or grant agreements.

§___.215 Relation to other audit requirements.

(a) Audit under this part in lieu of other audits. An audit made in accordance with this part shall be in lieu of any financial audit required under individual Federal awards. To the extent this audit meets a Federal agency's needs, it shall rely upon and use such audits. The provisions of this part neither limit the authority of Federal agencies, including their Inspectors General, or GAO to conduct or arrange for additional audits (e.g., financial audits, performance audits, evaluations, inspections, or reviews) nor authorize any auditee to constrain Federal
agencies from carrying out additional audits. Any additional audits shall be planned and performed in such a way as to build upon work performed by other auditors.

(b) Federal agency to pay for additional audits. A Federal agency that conducts or contracts for additional audits shall, consistent with other applicable laws and regulations, arrange for funding the full cost of such additional audits.

(c) Request for a program to be audited as a major program. A Federal agency may request an auditee to have a particular Federal program audited as a major program in lieu of the Federal agency conducting or arranging for the additional audits. To allow for planning, such requests should be made at least 180 days prior to the end of the fiscal year to be audited. The auditee, after consultation with its auditor, should promptly respond to such request by informing the Federal agency whether the program would otherwise be audited as a major program using the risk-based audit approach described in § .520 and, if not, the estimated incremental cost. The Federal agency shall then promptly confirm to the auditee whether it wants the program audited as a major program. If the program is to be audited as a major program based upon this Federal agency request, and the Federal agency agrees to pay the full incremental costs, then the auditee shall have the program audited as a major program. A pass-through entity may use the provisions of this paragraph for a subrecipient.

§ .220 Frequency of audits.

Except for the provisions for biennial audits provided in paragraphs (a) and (b) of this section, audits required by this part shall be performed annually. Any biennial audit shall cover both years within the biennial period.

(a) A State or local government that is required by constitution or statute, in effect on January 1, 1987, to undergo its audits less frequently than annually, is permitted to undergo its audits pursuant to this part biennially. This requirement must still be in effect for the biennial period under audit.

(b) Any non-profit organization that had biennial audits for all biennial periods ending between July 1, 1992, and January 1, 1995, is permitted to undergo its audits pursuant to this part biennially.

§ .225 Sanctions.

No audit costs may be charged to Federal awards when audits required by this part have not been made or have been made but not in accordance with this part. In cases of continued inability or unwillingness to have an audit conducted in accordance with this part, Federal agencies and pass-through entities shall take appropriate action using sanctions such as:

(a) Withholding a percentage of Federal awards until the audit is completed satisfactorily;

(b) Withholding or disallowing overhead costs;

(c) Suspending Federal awards until the audit is conducted; or

(d) Terminating the Federal award.

§ .230 Audit costs.

(a) Allowable costs. Unless prohibited by law, the cost of audits made in accordance with the provisions of this part are allowable charges to Federal awards. The charges may be considered a direct cost or an allocated indirect cost, as determined in accordance with the provisions of applicable OMB cost principles circulars, the Federal Acquisition Regulation (FAR) (48 CFR parts 30 and 31), or other applicable cost principles or regulations.

(b) Unallowable costs. A non-Federal entity shall not charge the following to a Federal award:

(1) The cost of any audit under the Single Audit Act Amendments of 1996 (31 U.S.C. 7501 et seq.) not conducted in accordance with this part.

(2) The cost of auditing a non-Federal entity which has Federal awards expended of less than $300,000 per year and is thereby exempted under § .200(d) from having an audit conducted under this part. However, this
does not prohibit a pass-through entity from charging Federal awards for the cost of limited scope audits to monitor its subrecipients in accordance with §____.400(d)(3), provided the subrecipient does not have a single audit. For purposes of this part, limited scope audits only include agreed-upon procedures engagements conducted in accordance with either the AICPA’s generally accepted auditing standards or attestation standards, that are paid for and arranged by a pass-through entity and address only one or more of the following types of compliance requirements: activities allowed or unallowed; allowable costs/cost principles; eligibility; matching, level of effort, earmarking; and, reporting.

§____.235 Program-specific audits.

(a) Program-specific audit guide available. In many cases, a program-specific audit guide will be available to provide specific guidance to the auditor with respect to internal control, compliance requirements, suggested audit procedures, and audit reporting requirements. The auditor should contact the Office of Inspector General of the Federal agency to determine whether such a guide is available. When a current program-specific audit guide is available, the auditor shall follow GAGAS and the guide when performing a program-specific audit.

(b) Program-specific audit guide not available. (1) When a program-specific audit guide is not available, the auditee and auditor shall have basically the same responsibilities for the Federal program as they would have for an audit of a major program in a single audit.

(2) The auditee shall prepare the financial statement(s) for the Federal program that includes, at a minimum, a schedule of expenditures of Federal awards for the program and notes that describe the significant accounting policies used in preparing the schedule, a summary schedule of prior audit findings consistent with the requirements of §____.315(b), and a corrective action plan consistent with the requirements of §____.315(c).

(3) The auditor shall:

(i) Perform an audit of the financial statement(s) for the Federal program in accordance with GAGAS;

(ii) Obtain an understanding of internal control and perform tests of internal control over the Federal program consistent with the requirements of §____.500(c) for a major program;

(iii) Perform procedures to determine whether the auditee has complied with laws, regulations, and the provisions of contracts or grant agreements that could have a direct and material effect on the Federal program consistent with the requirements of §____.500(d) for a major program; and

(iv) Follow up on prior audit findings, perform procedures to assess the reasonableness of the summary schedule of prior audit findings prepared by the auditee, and report, as a current year audit finding, when the auditor concludes that the summary schedule of prior audit findings materially misrepresents the status of any prior audit finding in accordance with the requirements of §____.500(e).

(4) The auditor’s report(s) may be in the form of either combined or separate reports and may be organized differently from the manner presented in this section. The auditor’s report(s) shall state that the audit was conducted in accordance with this part and include the following:

(i) An opinion (or disclaimer of opinion) as to whether the financial statement(s) of the Federal program is presented fairly in all material respects in conformity with the stated accounting policies;

(ii) A report on internal control related to the Federal program, which shall describe the scope of testing of internal control and the results of the tests;

(iii) A report on compliance which includes an opinion (or disclaimer of opinion) as to whether the auditee complied with laws, regulations, and the provisions of contracts or grant agreements which could have a direct and material effect on the Federal program; and

(iv) A schedule of findings and questioned costs for the Federal program that includes a summary of the auditor’s results relative to the Federal program in a format consistent with §____.505(d)(1) and findings and questioned costs consistent with the requirements of §____.505(d)(3).
(c) Report submission for program-specific audits.

(1) The audit shall be completed and the reporting required by paragraph (c)(2) or (c)(3) of this section submitted within the earlier of 30 days after receipt of the auditor’s report(s), or nine months after the end of the audit period, unless a longer period is agreed to in advance by the Federal agency that provided the funding or a different period is specified in a program-specific audit guide. (However, for fiscal years beginning on or before June 30, 1998, the audit shall be completed and the required reporting shall be submitted within the earlier of 30 days after receipt of the auditor’s report(s), or 13 months after the end of the audit period, unless a different period is specified in a program-specific audit guide.) Unless restricted by law or regulation, the auditee shall make report copies available for public inspection.

(2) When a program-specific audit guide is available, the auditee shall submit to the Federal clearinghouse designated by OMB the data collection form prepared in accordance with §__.320(b), as applicable to a program-specific audit, and the reporting required by the program-specific audit guide to be retained as an archival copy. Also, the auditee shall submit to the Federal awarding agency or pass-through entity the reporting required by the program-specific audit guide.

(3) When a program-specific audit guide is not available, the reporting package for a program-specific audit shall consist of the financial statement(s) of the Federal program, a summary schedule of prior audit findings, and a corrective action plan as described in paragraph (b)(2) of this section, and the auditor’s report(s) described in paragraph (b)(4) of this section. The data collection form prepared in accordance with §__.320(b), as applicable to a program-specific audit, and one copy of this reporting package shall be submitted to the Federal clearinghouse designated by OMB to be retained as an archival copy. Also, when the schedule of findings and questioned costs disclosed audit findings or the summary schedule of prior audit findings reported the status of any audit findings, the auditee shall submit one copy of the reporting package to the Federal clearinghouse on behalf of the Federal awarding agency, or directly to the pass-through entity in the case of a subrecipient. Instead of submitting the reporting package to the pass-through entity, when a subrecipient is not required to submit a reporting package to the pass-through entity, the subrecipient shall provide written notification to the pass-through entity, consistent with the requirements of §__.320(e)(2). A subrecipient may submit a copy of the reporting package to the pass-through entity to comply with this notification requirement.

(d) Other sections of this part may apply. Program-specific audits are subject to §__.100 through §__.215(b), §__.220 through §__.230, §__.300 through §__.305, §__.315, §__.320(f) through §__.320(j), §__.400 through §__.405, §__.510 through §__.515, and other referenced provisions of this part unless contrary to the provisions of this section, a program-specific audit guide, or program laws and regulations.

Subpart C--Auditees

§__.300 Auditee responsibilities.

The auditee shall:

(a) Identify, in its accounts, all Federal awards received and expended and the Federal programs under which they were received. Federal program and award identification shall include, as applicable, the CFDA title and number, award number and year, name of the Federal agency, and name of the pass-through entity.

(b) Maintain internal control over Federal programs that provides reasonable assurance that the auditee is managing Federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its Federal programs.

(c) Comply with laws, regulations, and the provisions of contracts or grant agreements related to each of its Federal programs.

(d) Prepare appropriate financial statements, including the schedule of expenditures of Federal awards in accordance with §__.310.

(e) Ensure that the audits required by this part are properly performed and submitted when due. When extensions to the report submission due date required by §__.320(a) are granted by the cognizant or oversight
agency for audit, promptly notify the Federal clearinghouse designated by OMB and each pass-through entity providing Federal awards of the extension.

(f) Follow up and take corrective action on audit findings, including preparation of a summary schedule of prior audit findings and a corrective action plan in accordance with §___.315(b) and §___.315(c), respectively.

§___.305 Auditor selection.

(a) Auditor procurement. In procuring audit services, auditees shall follow the procurement standards prescribed by the Grants Management Common Rule (hereinafter referred to as the "A-102 Common Rule") published March 11, 1988 and amended April 19, 1995 [insert appropriate CFR citation], Circular A-110, "Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals and Other Non-Profit Organizations," or the FAR (48 CFR part 42), as applicable (OMB Circulars are available from the Office of Administration, Publications Office, room 2200, New Executive Office Building, Washington, DC 20503). Whenever possible, auditees shall make positive efforts to utilize small businesses, minority-owned firms, and women's business enterprises, in procuring audit services as stated in the A-102 Common Rule, OMB Circular A-110, or the FAR (48 CFR part 42), as applicable. In requesting proposals for audit services, the objectives and scope of the audit should be made clear. Factors to be considered in evaluating each proposal for audit services include the responsiveness to the request for proposal, relevant experience, availability of staff with professional qualifications and technical abilities, the results of external quality control reviews, and price.

(b) Restriction on auditor preparing indirect cost proposals. An auditor who prepares the indirect cost proposal or cost allocation plan may not also be selected to perform the audit required by this part when the indirect costs recovered by the auditee during the prior year exceeded $1 million. This restriction applies to the base year used in the preparation of the indirect cost proposal or cost allocation plan and any subsequent years in which the resulting indirect cost agreement or cost allocation plan is used to recover costs. To minimize any disruption in existing contracts for audit services, this paragraph applies to audits of fiscal years beginning after June 30, 1998.

(c) Use of Federal auditors. Federal auditors may perform all or part of the work required under this part if they comply fully with the requirements of this part.

§___.310 Financial statements.

(a) Financial statements. The auditee shall prepare financial statements that reflect its financial position, results of operations or changes in net assets, and, where appropriate, cash flows for the fiscal year audited. The financial statements shall be for the same organizational unit and fiscal year that is chosen to meet the requirements of this part. However, organization-wide financial statements may also include departments, agencies, and other organizational units that have separate audits in accordance with §___.500(a) and prepare separate financial statements.

(b) Schedule of expenditures of Federal awards. The auditee shall also prepare a schedule of expenditures of Federal awards for the period covered by the auditee's financial statements. While not required, the auditee may choose to provide information requested by Federal awarding agencies and pass-through entities to make the schedule easier to use. For example, when a Federal program has multiple award years, the auditee may list the amount of Federal awards expended for each award year separately. At a minimum, the schedule shall:

(1) List individual Federal programs by Federal agency. For Federal programs included in a cluster of programs, list individual Federal programs within a cluster of programs. For R&D, total Federal awards expended shall be shown either by individual award or by Federal agency and major subdivision within the Federal agency. For example, the National Institutes of Health is a major subdivision in the Department of Health and Human Services.

(2) For Federal awards received as a subrecipient, the name of the pass-through entity and identifying number assigned by the pass-through entity shall be included.

(3) Provide total Federal awards expended for each individual Federal program and the CFDA number or other identifying number when the CFDA information is not available.

(4) Include notes that describe the significant accounting policies used in preparing the schedule.
(5) To the extent practical, pass-through entities should identify in the schedule the total amount provided to subrecipients from each Federal program.

(6) Include, in either the schedule or a note to the schedule, the value of the Federal awards expended in the form of non-cash assistance, the amount of insurance in effect during the year, and loans or loan guarantees outstanding at year end. While not required, it is preferable to present this information in the schedule.

§___.315 Audit findings follow-up.

(a) General. The auditee is responsible for follow-up and corrective action on all audit findings. As part of this responsibility, the auditee shall prepare a summary schedule of prior audit findings. The auditee shall also prepare a corrective action plan for current year audit findings. The summary schedule of prior audit findings and the corrective action plan shall include the reference numbers the auditor assigns to audit findings under §___.510(c). Since the summary schedule may include audit findings from multiple years, it shall include the fiscal year in which the finding initially occurred.

(b) Summary schedule of prior audit findings. The summary schedule of prior audit findings shall report the status of all audit findings included in the prior audit's schedule of findings and questioned costs relative to Federal awards. The summary schedule shall also include audit findings reported in the prior audit's summary schedule of prior audit findings except audit findings listed as corrected in accordance with paragraph (b)(1) of this section, or no longer valid or not warranting further action in accordance with paragraph (b)(4) of this section.

(1) When audit findings were fully corrected, the summary schedule need only list the audit findings and state that corrective action was taken.

(2) When audit findings were not corrected or were only partially corrected, the summary schedule shall describe the planned corrective action as well as any partial corrective action taken.

(3) When corrective action taken is significantly different from corrective action previously reported in a corrective action plan or in the Federal agency's or pass-through entity's management decision, the summary schedule shall provide an explanation.

(4) When the auditee believes the audit findings are no longer valid or do not warrant further action, the reasons for this position shall be described in the summary schedule. A valid reason for considering an audit finding as not warranting further action is that all of the following have occurred:

   (i) Two years have passed since the audit report in which the finding occurred was submitted to the Federal clearinghouse;

   (ii) The Federal agency or pass-through entity is not currently following up with the auditee on the audit finding; and

   (iii) A management decision was not issued.

(c) Corrective action plan. At the completion of the audit, the auditee shall prepare a corrective action plan to address each audit finding included in the current year auditor's reports. The corrective action plan shall provide the name(s) of the contact person(s) responsible for corrective action, the corrective action planned, and the anticipated completion date. If the auditee does not agree with the audit findings or believes corrective action is not required, then the corrective action plan shall include an explanation and specific reasons.

§___.320 Report submission.

(a) General. The audit shall be completed and the data collection form described in paragraph (b) of this section and reporting package described in paragraph (c) of this section shall be submitted within the earlier of 30 days after receipt of the auditor's report(s), or nine months after the end of the audit period, unless a longer period is agreed to in advance by the cognizant or oversight agency for audit. (However, for fiscal years beginning on or before June 30, 1998, the audit shall be completed and the data collection form and reporting package shall be submitted within the earlier of 30 days after receipt of the auditor's report(s), or 13 months after the end of the audit period.) Unless restricted by law or regulation, the auditee shall make copies available for public inspection.
(b) Data Collection. (1) The auditee shall submit a data collection form which states whether the audit was completed in accordance with this part and provides information about the auditee, its Federal programs, and the results of the audit. The form shall be approved by OMB, available from the Federal clearinghouse designated by OMB, and include data elements similar to those presented in this paragraph. A senior level representative of the auditee (e.g., State controller, director of finance, chief executive officer, or chief financial officer) shall sign a statement to be included as part of the form certifying that: the auditee complied with the requirements of this part, the form was prepared in accordance with this part (and the instructions accompanying the form), and the information included in the form, in its entirety, are accurate and complete.

(2) The data collection form shall include the following data elements:

(i) The type of report the auditor issued on the financial statements of the auditee (i.e., unqualified opinion, qualified opinion, adverse opinion, or disclaimer of opinion).

(ii) Where applicable, a statement that reportable conditions in internal control were disclosed by the audit of the financial statements and whether any such conditions were material weaknesses.

(iii) A statement as to whether the audit disclosed any noncompliance which is material to the financial statements of the auditee.

(iv) Where applicable, a statement that reportable conditions in internal control over major programs were disclosed by the audit and whether any such conditions were material weaknesses.

(v) The type of report the auditor issued on compliance for major programs (i.e., unqualified opinion, qualified opinion, adverse opinion, or disclaimer of opinion).

(vi) A list of the Federal awarding agencies which will receive a copy of the reporting package pursuant to §___.320(d)(2) of OMB Circular A-133.

(vii) A yes or no statement as to whether the auditee qualified as a low-risk auditee under §___.530 of OMB Circular A-133.

(viii) The dollar threshold used to distinguish between Type A and Type B programs as defined in §___.520(b) of OMB Circular A-133.

(ix) The Catalog of Federal Domestic Assistance (CFDA) number for each Federal program, as applicable.

(x) The name of each Federal program and identification of each major program. Individual programs within a cluster of programs should be listed in the same level of detail as they are listed in the schedule of expenditures of Federal awards.

(xi) The amount of expenditures in the schedule of expenditures of Federal awards associated with each Federal program.

(xii) For each Federal program, a yes or no statement as to whether there are audit findings in each of the following types of compliance requirements and the total amount of any questioned costs:

(A) Activities allowed or unallowed.

(B) Allowable costs/cost principles.

(C) Cash management.

(D) Davis-Bacon Act.

(E) Eligibility.

(F) Equipment and real property management.
(G) Matching, level of effort, earmarking.

(H) Period of availability of Federal funds.

(I) Procurement and suspension and debarment.

(J) Program income.

(K) Real property acquisition and relocation assistance.

(L) Reporting.

(M) Subrecipient monitoring.

(N) Special tests and provisions.

(xiii) Auditee Name, Employer Identification Number(s), Name and Title of Certifying Official, Telephone Number, Signature, and Date.

(xiv) Auditor Name, Name and Title of Contact Person, Auditor Address, Auditor Telephone Number, Signature, and Date.

(xv) Whether the auditee has either a cognizant or oversight agency for audit.

(xvi) The name of the cognizant or oversight agency for audit determined in accordance with §__.400(a) and §__.400(b), respectively.

(3) Using the information included in the reporting package described in paragraph (c) of this section, the auditor shall complete the applicable sections of the form. The auditor shall sign a statement to be included as part of the data collection form that indicates, at a minimum, the source of the information included in the form, the auditor's responsibility for the information, that the form is not a substitute for the reporting package described in paragraph (c) of this section, and that the content of the form is limited to the data elements prescribed by OMB.

(c) Reporting package. The reporting package shall include the:

(1) Financial statements and schedule of expenditures of Federal awards discussed in §__.310(a) and §__.310(b), respectively;

(2) Summary schedule of prior audit findings discussed in §__.315(b);

(3) Auditor's report(s) discussed in §__.505; and

(4) Corrective action plan discussed in §__.315(c).

(d) Submission to clearinghouse. All auditees shall submit to the Federal clearinghouse designated by OMB the data collection form described in paragraph (b) of this section and one copy of the reporting package described in paragraph (c) of this section for:

(1) The Federal clearinghouse to retain as an archival copy; and

(2) Each Federal awarding agency when the schedule of findings and questioned costs disclosed audit findings relating to Federal awards that the Federal awarding agency provided directly or the summary schedule of prior audit findings reported the status of any audit findings relating to Federal awards that the Federal awarding agency provided directly.

(e) Additional submission by subrecipients. (1) In addition to the requirements discussed in paragraph (d) of this section, auditees that are also subrecipients shall submit to each pass-through entity one copy of the reporting package described in paragraph (c) of this section for each pass-through entity when the schedule of findings and
questioned costs disclosed audit findings relating to Federal awards that the pass-through entity provided or the summary schedule of prior audit findings reported the status of any audit findings relating to Federal awards that the pass-through entity provided.

(2) Instead of submitting the reporting package to a pass-through entity, when a subrecipient is not required to submit a reporting package to a pass-through entity pursuant to paragraph (e)(1) of this section, the subrecipient shall provide written notification to the pass-through entity that: an audit of the subrecipient was conducted in accordance with this part (including the period covered by the audit and the name, amount, and CFDA number of the Federal award(s) provided by the pass-through entity); the schedule of findings and questioned costs disclosed no audit findings relating to the Federal award(s) that the pass-through entity provided; and, the summary schedule of prior audit findings did not report on the status of any audit findings relating to the Federal award(s) that the pass-through entity provided. A subrecipient may submit a copy of the reporting package described in paragraph (c) of this section to a pass-through entity to comply with this notification requirement.

(f) Requests for report copies. In response to requests by a Federal agency or pass-through entity, auditees shall submit the appropriate copies of the reporting package described in paragraph (c) of this section and, if requested, a copy of any management letters issued by the auditor.

(g) Report retention requirements. Auditees shall keep one copy of the data collection form described in paragraph (b) of this section and one copy of the reporting package described in paragraph (c) of this section on file for three years from the date of submission to the Federal clearinghouse designated by OMB. Pass-through entities shall keep subrecipients’ submissions on file for three years from date of receipt.

(h) Clearinghouse responsibilities. The Federal clearinghouse designated by OMB shall distribute the reporting packages received in accordance with paragraph (d)(2) of this section and §___.235(c)(3) to applicable Federal awarding agencies, maintain a data base of completed audits, provide appropriate information to Federal agencies, and follow up with known auditees which have not submitted the required data collection forms and reporting packages.

(i) Clearinghouse address. The address of the Federal clearinghouse currently designated by OMB is Federal Audit Clearinghouse, Bureau of the Census, 1201 E. 10th Street, Jeffersonville, IN 47132.

(j) Electronic filing. Nothing in this part shall preclude electronic submissions to the Federal clearinghouse in such manner as may be approved by OMB. With OMB approval, the Federal clearinghouse may pilot test methods of electronic submissions.

Subpart D--Federal Agencies and Pass-Through Entities

§___.400 Responsibilities.

(a) Cognizant agency for audit responsibilities. Recipients expending more than $25 million a year in Federal awards shall have a cognizant agency for audit. The designated cognizant agency for audit shall be the Federal awarding agency that provides the predominant amount of direct funding to a recipient unless OMB makes a specific cognizant agency for audit assignment. To provide for continuity of cognizance, the determination of the predominant amount of direct funding shall be based upon direct Federal awards expended in the recipient's fiscal years ending in 1995, 2000, 2005, and every fifth year thereafter. For example, audit cognizance for periods ending in 1997 through 2000 will be determined based on Federal awards expended in 1995. (However, for States and local governments that expend more than $25 million a year in Federal awards and have previously assigned cognizant agencies for audit, the requirements of this paragraph are not effective until fiscal years beginning after June 30, 2000.) Notwithstanding the manner in which audit cognizance is determined, a Federal awarding agency with cognizance for an auditee may reassign cognizance to another Federal awarding agency which provides substantial direct funding and agrees to be the cognizant agency for audit. Within 30 days after any reassignment, both the old and the new cognizant agency for audit shall notify the auditee, and, if known, the auditor of the reassignment. The cognizant agency for audit shall:

(1) Provide technical audit advice and liaison to auditees and auditors.
(2) Consider auditee requests for extensions to the report submission due date required by §___.320(a). The
cognizant agency for audit may grant extensions for good cause.

(3) Obtain or conduct quality control reviews of selected audits made by non-Federal auditors, and provide the
results, when appropriate, to other interested organizations.

(4) Promptly inform other affected Federal agencies and appropriate Federal law enforcement officials of any
direct reporting by the auditee or its auditor of irregularities or illegal acts, as required by GAGAS or laws and
regulations.

(5) Advise the auditor and, where appropriate, the auditee of any deficiencies found in the audits when the
deficiencies require corrective action by the auditor. When advised of deficiencies, the auditee shall work with the
auditor to take corrective action. If corrective action is not taken, the cognizant agency for audit shall notify the
auditor, the auditee, and applicable Federal awarding agencies and pass-through entities of the facts and make
recommendations for follow-up action. Major inadequacies or repetitive substandard performance by auditors shall
be referred to appropriate State licensing agencies and professional bodies for disciplinary action.

(6) Coordinate, to the extent practical, audits or reviews made by or for Federal agencies that are in addition to
the audits made pursuant to this part, so that the additional audits or reviews build upon audits performed in
accordance with this part.

(7) Coordinate a management decision for audit findings that affect the Federal programs of more than one
agency.

(8) Coordinate the audit work and reporting responsibilities among auditors to achieve the most cost-effective
audit.

(9) For biennial audits permitted under §___.220, consider auditee requests to qualify as a low-risk auditee
under §___.530(a).

(b) Oversight agency for audit responsibilities. An auditee which does not have a designated cognizant agency
for audit will be under the general oversight of the Federal agency determined in accordance with §___.105. The
oversight agency for audit:

(1) Shall provide technical advice to auditees and auditors as requested.

(2) May assume all or some of the responsibilities normally performed by a cognizant agency for audit.

(c) Federal awarding agency responsibilities. The Federal awarding agency shall perform the following for the
Federal awards it makes:

(1) Identify Federal awards made by informing each recipient of the CFDA title and number, award name and
number, award year, and if the award is for R&D. When some of this information is not available, the Federal
agency shall provide information necessary to clearly describe the Federal award.

(2) Advise recipients of requirements imposed on them by Federal laws, regulations, and the provisions of
contracts or grant agreements.

(3) Ensure that audits are completed and reports are received in a timely manner and in accordance with the
requirements of this part.

(4) Provide technical advice and counsel to auditees and auditors as requested.

(5) Issue a management decision on audit findings within six months after receipt of the audit report and
ensure that the recipient takes appropriate and timely corrective action.

(6) Assign a person responsible for providing annual updates of the compliance supplement to OMB.
(d) Pass-through entity responsibilities. A pass-through entity shall perform the following for the Federal awards it makes:

(1) Identify Federal awards made by informing each subrecipient of CFDA title and number, award name and number, award year, if the award is R&D, and name of Federal agency. When some of this information is not available, the pass-through entity shall provide the best information available to describe the Federal award.

(2) Advise subrecipients of requirements imposed on them by Federal laws, regulations, and the provisions of contracts or grant agreements as well as any supplemental requirements imposed by the pass-through entity.

(3) Monitor the activities of subrecipients as necessary to ensure that Federal awards are used for authorized purposes in compliance with laws, regulations, and the provisions of contracts or grant agreements and that performance goals are achieved.

(4) Ensure that subrecipients expending $300,000 or more in Federal awards during the subrecipient’s fiscal year have met the audit requirements of this part for that fiscal year.

(5) Issue a management decision on audit findings within six months after receipt of the subrecipient’s audit report and ensure that the subrecipient takes appropriate and timely corrective action.

(6) Consider whether subrecipient audits necessitate adjustment of the pass-through entity’s own records.

(7) Require each subrecipient to permit the pass-through entity and auditors to have access to the records and financial statements as necessary for the pass-through entity to comply with this part.

§ ___ .405 Management decision.

(a) General. The management decision shall clearly state whether or not the audit finding is sustained, the reasons for the decision, and the expected auditee action to repay disallowed costs, make financial adjustments, or take other action. If the auditee has not completed corrective action, a timetable for follow-up should be given. Prior to issuing the management decision, the Federal agency or pass-through entity may request additional information or documentation from the auditee, including a request for auditor assurance related to the documentation, as a way of mitigating disallowed costs. The management decision should describe any appeal process available to the auditee.

(b) Federal agency. As provided in § ___ .400(a)(7), the cognizant agency for audit shall be responsible for coordinating a management decision for audit findings that affect the programs of more than one Federal agency. As provided in § ___ .400(c)(5), a Federal awarding agency is responsible for issuing a management decision for findings that relate to Federal awards it makes to recipients. Alternate arrangements may be made on a case-by-case basis by agreement among the Federal agencies concerned.

(c) Pass-through entity. As provided in § ___ .400(d)(5), the pass-through entity shall be responsible for making the management decision for audit findings that relate to Federal awards it makes to subrecipients.

(d) Time requirements. The entity responsible for making the management decision shall do so within six months of receipt of the audit report. Corrective action should be initiated within six months after receipt of the audit report and proceed as rapidly as possible.

(e) Reference numbers. Management decisions shall include the reference numbers the auditor assigned to each audit finding in accordance with § ___ .510(c).
Subpart E--Auditors

§ 500 Scope of audit.

(a) General. The audit shall be conducted in accordance with GAGAS. The audit shall cover the entire operations of the auditee; or, at the option of the auditee, such audit shall include a series of audits that cover departments, agencies, and other organizational units which expended or otherwise administered Federal awards during such fiscal year, provided that each such audit shall encompass the financial statements and schedule of expenditures of Federal awards for each such department, agency, and other organizational unit, which shall be considered to be a non-Federal entity. The financial statements and schedule of expenditures of Federal awards shall be for the same fiscal year.

(b) Financial statements. The auditor shall determine whether the financial statements of the auditee are presented fairly in all material respects in conformity with generally accepted accounting principles. The auditor shall also determine whether the schedule of expenditures of Federal awards is presented fairly in all material respects in relation to the auditee’s financial statements taken as a whole.

(c) Internal control. (1) In addition to the requirements of GAGAS, the auditor shall perform procedures to obtain an understanding of internal control over Federal programs sufficient to plan the audit to support a low assessed level of control risk for major programs.

(2) Except as provided in paragraph (c)(3) of this section, the auditor shall:

(i) Plan the testing of internal control over major programs to support a low assessed level of control risk for the assertions relevant to the compliance requirements for each major program; and

(ii) Perform testing of internal control as planned in paragraph (c)(2)(i) of this section.

(3) When internal control over some or all of the compliance requirements for a major program are likely to be ineffective in preventing or detecting noncompliance, the planning and performing of testing described in paragraph (c)(2) of this section are not required for those compliance requirements. However, the auditor shall report a reportable condition (including whether any such condition is a material weakness) in accordance with § 510, assess the related control risk at the maximum, and consider whether additional compliance tests are required because of ineffective internal control.

(d) Compliance. (1) In addition to the requirements of GAGAS, the auditor shall determine whether the auditee has complied with laws, regulations, and the provisions of contracts or grant agreements that may have a direct and material effect on each of its major programs.

(2) The principal compliance requirements applicable to most Federal programs and the compliance requirements of the largest Federal programs are included in the compliance supplement.

(3) For the compliance requirements related to Federal programs contained in the compliance supplement, an audit of these compliance requirements will meet the requirements of this part. Where there have been changes to the compliance requirements and the changes are not reflected in the compliance supplement, the auditor shall determine the current compliance requirements and modify the audit procedures accordingly. For those Federal programs not covered in the compliance supplement, the auditor should use the types of compliance requirements contained in the compliance supplement as guidance for identifying the types of compliance requirements to test, and determine the requirements governing the Federal program by reviewing the provisions of contracts and grant agreements and the laws and regulations referred to in such contracts and grant agreements.

(4) The compliance testing shall include tests of transactions and such other auditing procedures necessary to provide the auditor sufficient evidence to support an opinion on compliance.

(e) Audit follow-up. The auditor shall follow-up on prior audit findings, perform procedures to assess the reasonableness of the summary schedule of prior audit findings prepared by the auditee in accordance with § 315(b), and report, as a current year audit finding, when the auditor concludes that the summary schedule of prior audit findings materially misrepresents the status of any prior audit finding. The auditor shall perform audit follow-up procedures regardless of whether a prior audit finding relates to a major program in the current year.
Data Collection Form. As required in §____.320(b)(3), the auditor shall complete and sign specified sections of the data collection form.

§____.505 Audit reporting.

The auditor's report(s) may be in the form of either combined or separate reports and may be organized differently from the manner presented in this section. The auditor's report(s) shall state that the audit was conducted in accordance with this part and include the following:

(a) An opinion (or disclaimer of opinion) as to whether the financial statements are presented fairly in all material respects in conformity with generally accepted accounting principles and an opinion (or disclaimer of opinion) as to whether the schedule of expenditures of Federal awards is presented fairly in all material respects in relation to the financial statements taken as a whole.

(b) A report on internal control related to the financial statements and major programs. This report shall describe the scope of testing of internal control and the results of the tests, and, where applicable, refer to the separate schedule of findings and questioned costs described in paragraph (d) of this section.

(c) A report on compliance with laws, regulations, and the provisions of contracts or grant agreements, noncompliance with which could have a material effect on the financial statements. This report shall also include an opinion (or disclaimer of opinion) as to whether the auditee complied with laws, regulations, and the provisions of contracts or grant agreements which could have a direct and material effect on each major program, and, where applicable, refer to the separate schedule of findings and questioned costs described in paragraph (d) of this section.

(d) A schedule of findings and questioned costs which shall include the following three components:

(1) A summary of the auditor's results which shall include:

(i) The type of report the auditor issued on the financial statements of the auditee (i.e., unqualified opinion, qualified opinion, adverse opinion, or disclaimer of opinion);

(ii) Where applicable, a statement that reportable conditions in internal control were disclosed by the audit of the financial statements and whether any such conditions were material weaknesses;

(iii) A statement as to whether the audit disclosed any noncompliance which is material to the financial statements of the auditee;

(iv) Where applicable, a statement that reportable conditions in internal control over major programs were disclosed by the audit and whether any such conditions were material weaknesses;

(v) The type of report the auditor issued on compliance for major programs (i.e., unqualified opinion, qualified opinion, adverse opinion, or disclaimer of opinion);

(vi) A statement as to whether the audit disclosed any audit findings which the auditor is required to report under §____.510(a);

(vii) An identification of major programs;

(viii) The dollar threshold used to distinguish between Type A and Type B programs, as described in §____.520(b); and

(ix) A statement as to whether the auditee qualified as a low-risk auditee under §____.530.

(2) Findings relating to the financial statements which are required to be reported in accordance with GAGAS.

(3) Findings and questioned costs for Federal awards which shall include audit findings as defined in §____.510(a).
(i) Audit findings (e.g., internal control findings, compliance findings, questioned costs, or fraud) which relate to
the same issue should be presented as a single audit finding. Where practical, audit findings should be organized
by Federal agency or pass-through entity.

(ii) Audit findings which relate to both the financial statements and Federal awards, as reported under
paragraphs (d)(2) and (d)(3) of this section, respectively, should be reported in both sections of the schedule.
However, the reporting in one section of the schedule may be in summary form with a reference to a detailed
reporting in the other section of the schedule.

§ 510 Audit findings.

(a) Audit findings reported. The auditor shall report the following as audit findings in a schedule of findings and
questioned costs:

(1) Reportable conditions in internal control over major programs. The auditor's determination of whether a
deficiency in internal control is a reportable condition for the purpose of reporting an audit finding is in relation to a
type of compliance requirement for a major program or an audit objective identified in the compliance supplement.
The auditor shall identify reportable conditions which are individually or cumulatively material weaknesses.

(2) Material noncompliance with the provisions of laws, regulations, contracts, or grant agreements related to a
major program. The auditor's determination of whether a noncompliance with the provisions of laws, regulations,
contracts, or grant agreements is material for the purpose of reporting an audit finding is in relation to a type of
compliance requirement for a major program or an audit objective identified in the compliance supplement.

(3) Known questioned costs which are greater than $10,000 for a type of compliance requirement for a major
program. Known questioned costs are those specifically identified by the auditor. In evaluating the effect of
questioned costs on the opinion on compliance, the auditor considers the best estimate of total costs questioned
(likely questioned costs), not just the questioned costs specifically identified (known questioned costs). The auditor
shall also report known questioned costs when likely questioned costs are greater than $10,000 for a type of
compliance requirement for a major program. In reporting questioned costs, the auditor shall include information to
provide proper perspective for judging the prevalence and consequences of the questioned costs.

(4) Known questioned costs which are greater than $10,000 for a Federal program which is not audited as a
major program. Except for audit follow-up, the auditor is not required under this part to perform audit procedures
for such a Federal program; therefore, the auditor will normally not find questioned costs for a program which is
not audited as a major program. However, if the auditor does become aware of questioned costs for a Federal
program which is not audited as a major program (e.g., as part of audit follow-up or other audit procedures) and
the known questioned costs are greater than $10,000, then the auditor shall report this as an audit finding.

(5) The circumstances concerning why the auditor's report on compliance for major programs is other than an
unqualified opinion, unless such circumstances are otherwise reported as audit findings in the schedule of findings
and questioned costs for Federal awards.

(6) Known fraud affecting a Federal award, unless such fraud is otherwise reported as an audit finding in the
schedule of findings and questioned costs for Federal awards. This paragraph does not require the auditor to make
an additional reporting when the auditor confirms that the fraud was reported outside of the auditor's reports
under the direct reporting requirements of GAGAS.

(7) Instances where the results of audit follow-up procedures disclosed that the summary schedule of prior
audit findings prepared by the auditee in accordance with § 315(b) materially misrepresents the status of any
prior audit finding.

(b) Audit finding detail. Audit findings shall be presented in sufficient detail for the auditee to prepare a
corrective action plan and take corrective action and for Federal agencies and pass-through entities to arrive at a
management decision. The following specific information shall be included, as applicable, in audit findings:

(1) Federal program and specific Federal award identification including the CFDA title and number, Federal
award number and year, name of Federal agency, and name of the applicable pass-through entity. When
information, such as the CFDA title and number or Federal award number, is not available, the auditor shall provide the best information available to describe the Federal award.

(2) The criteria or specific requirement upon which the audit finding is based, including statutory, regulatory, or other citation.

(3) The condition found, including facts that support the deficiency identified in the audit finding.

(4) Identification of questioned costs and how they were computed.

(5) Information to provide proper perspective for judging the prevalence and consequences of the audit findings, such as whether the audit findings represent an isolated instance or a systemic problem. Where appropriate, instances identified shall be related to the universe and the number of cases examined and be quantified in terms of dollar value.

(6) The possible asserted effect to provide sufficient information to the auditee and Federal agency, or pass-through entity in the case of a subrecipient, to permit them to determine the cause and effect to facilitate prompt and proper corrective action.

(7) Recommendations to prevent future occurrences of the deficiency identified in the audit finding.

(8) Views of responsible officials of the auditee when there is disagreement with the audit findings, to the extent practical.

(c) Reference numbers. Each audit finding in the schedule of findings and questioned costs shall include a reference number to allow for easy referencing of the audit findings during follow-up.

§__.515 Audit working papers.

(a) Retention of working papers. The auditor shall retain working papers and reports for a minimum of three years after the date of issuance of the auditor's report(s) to the auditee, unless the auditor is notified in writing by the cognizant agency for audit, oversight agency for audit, or pass-through entity to extend the retention period. When the auditor is aware that the Federal awarding agency, pass-through entity, or auditee is contesting an audit finding, the auditor shall contact the parties contesting the audit finding for guidance prior to destruction of the working papers and reports.

(b) Access to working papers. Audit working papers shall be made available upon request to the cognizant or oversight agency for audit or its designee, a Federal agency providing direct or indirect funding, or GAO at the completion of the audit, as part of a quality review, to resolve audit findings, or to carry out oversight responsibilities consistent with the purposes of this part. Access to working papers includes the right of Federal agencies to obtain copies of working papers, as is reasonable and necessary.

§__.520 Major program determination.

(a) General. The auditor shall use a risk-based approach to determine which Federal programs are major programs. This risk-based approach shall include consideration of: Current and prior audit experience, oversight by Federal agencies and pass-through entities, and the inherent risk of the Federal program. The process in paragraphs (b) through (i) of this section shall be followed.

(b) Step 1. (1) The auditor shall identify the larger Federal programs, which shall be labeled Type A programs. Type A programs are defined as Federal programs with Federal awards expended during the audit period exceeding the larger of:

   (i) $300,000 or three percent (.03) of total Federal awards expended in the case of an auditee for which total Federal awards expended equal or exceed $300,000 but are less than or equal to $100 million.

   (ii) $3 million or three-tenths of one percent (.003) of total Federal awards expended in the case of an auditee for which total Federal awards expended exceed $100 million but are less than or equal to $10 billion.
(iii) $30 million or 15 hundredths of one percent (.0015) of total Federal awards expended in the case of an auditee for which total Federal awards expended exceed $10 billion.

(2) Federal programs not labeled Type A under paragraph (b)(1) of this section shall be labeled Type B programs.

(3) The inclusion of large loan and loan guarantees (loans) should not result in the exclusion of other programs as Type A programs. When a Federal program providing loans significantly affects the number or size of Type A programs, the auditor shall consider this Federal program as a Type A program and exclude its values in determining other Type A programs.

(4) For biennial audits permitted under §___.220, the determination of Type A and Type B programs shall be based upon the Federal awards expended during the two-year period.

(c) Step 2. (1) The auditor shall identify Type A programs which are low-risk. For a Type A program to be considered low-risk, it shall have been audited as a major program in at least one of the two most recent audit periods (in the most recent audit period in the case of a biennial audit), and, in the most recent audit period, it shall have had no audit findings under §___.510(a). However, the auditor may use judgment and consider that audit findings from questioned costs under §___.510(a)(3) and §___.510(a)(4), fraud under §___.510(a)(6), and audit follow-up for the summary schedule of prior audit findings under §___.510(a)(7) do not preclude the Type A program from being low-risk. The auditor shall consider: the criteria in §___.525(c), §___.525(d)(1), §___.525(d)(2), and §___.525(d)(3); the results of audit follow-up; whether any changes in personnel or systems affecting a Type A program have significantly increased risk; and apply professional judgment in determining whether a Type A program is low-risk.

(2) Notwithstanding paragraph (c)(1) of this section, OMB may approve a Federal awarding agency's request that a Type A program at certain recipients may not be considered low-risk. For example, it may be necessary for a large Type A program to be audited as major each year at particular recipients to allow the Federal agency to comply with the Government Management Reform Act of 1994 (31 U.S.C. 3515). The Federal agency shall notify the recipient and, if known, the auditor at least 180 days prior to the end of the fiscal year to be audited of OMB's approval.

(d) Step 3. (1) The auditor shall identify Type B programs which are high-risk using professional judgment and the criteria in §___.525. However, should the auditor select Option 2 under Step 4 (paragraph (e)(2)(i)(B) of this section), the auditor is not required to identify more high-risk Type B programs than the number of low-risk Type A programs. Except for known reportable conditions in internal control or compliance problems as discussed in §___.525(b)(1), §___.525(b)(2), and §___.525(c)(1), a single criteria in §___.525 would seldom cause a Type B program to be considered high-risk.

(2) The auditor is not expected to perform risk assessments on relatively small Federal programs. Therefore, the auditor is only required to perform risk assessments on Type B programs that exceed the larger of:

(i) $100,000 or three-tenths of one percent (.003) of total Federal awards expended when the auditee has less than or equal to $100 million in total Federal awards expended.

(ii) $300,000 or three-hundredths of one percent (.0003) of total Federal awards expended when the auditee has more than $100 million in total Federal awards expended.

(e) Step 4. At a minimum, the auditor shall audit all of the following as major programs:

(1) All Type A programs, except the auditor may exclude any Type A programs identified as low-risk under Step 2 (paragraph (c)(1) of this section).

(2) (i) High-risk Type B programs as identified under either of the following two options:

(A) Option 1. At least one half of the Type B programs identified as high-risk under Step 3 (paragraph (d) of this section), except this paragraph (e)(2)(i)(A) does not require the auditor to audit more high-risk Type B programs than the number of low-risk Type A programs identified as low-risk under Step 2.
(B) Option 2. One high-risk Type B program for each Type A program identified as low-risk under Step 2.

(ii) When identifying which high-risk Type B programs to audit as major under either Option 1 or 2 in paragraph (e)(2)(i)(A) or (B), the auditor is encouraged to use an approach which provides an opportunity for different high-risk Type B programs to be audited as major over a period of time.

(3) Such additional programs as may be necessary to comply with the percentage of coverage rule discussed in paragraph (f) of this section. This paragraph (e)(3) may require the auditor to audit more programs as major than the number of Type A programs.

(f) Percentage of coverage rule. The auditor shall audit as major programs Federal programs with Federal awards expended that, in the aggregate, encompass at least 50 percent of total Federal awards expended. If the auditee meets the criteria in § .530 for a low-risk auditee, the auditor need only audit as major programs Federal programs with Federal awards expended that, in the aggregate, encompass at least 25 percent of total Federal awards expended.

(g) Documentation of risk. The auditor shall document in the working papers the risk analysis process used in determining major programs.

(h) Auditor's judgment. When the major program determination was performed and documented in accordance with this part, the auditor's judgment in applying the risk-based approach to determine major programs shall be presumed correct. Challenges by Federal agencies and pass-through entities shall only be for clearly improper use of the guidance in this part. However, Federal agencies and pass-through entities may provide auditors guidance about the risk of a particular Federal program and the auditor shall consider this guidance in determining major programs in audits not yet completed.

(i) Deviation from use of risk criteria. For first-year audits, the auditor may elect to determine major programs as all Type A programs plus any Type B programs as necessary to meet the percentage of coverage rule discussed in paragraph (f) of this section. Under this option, the auditor would not be required to perform the procedures discussed in paragraphs (c), (d), and (e) of this section.

(1) A first-year audit is the first year the entity is audited under this part or the first year of a change of auditors.

(2) To ensure that a frequent change of auditors would not preclude audit of high-risk Type B programs, this election for first-year audits may not be used by an auditee more than once in every three years.

§ .525 Criteria for Federal program risk.

(a) General. The auditor's determination should be based on an overall evaluation of the risk of noncompliance occurring which could be material to the Federal program. The auditor shall use auditor judgment and consider criteria, such as described in paragraphs (b), (c), and (d) of this section, to identify risk in Federal programs. Also, as part of the risk analysis, the auditor may wish to discuss a particular Federal program with auditee management and the Federal agency or pass-through entity.

(b) Current and prior audit experience. (1) Weaknesses in internal control over Federal programs would indicate higher risk. Consideration should be given to the control environment over Federal programs and such factors as the expectation of management's adherence to applicable laws and regulations and the provisions of contracts and grant agreements and the competence and experience of personnel who administer the Federal programs.

(i) A Federal program administered under multiple internal control structures may have higher risk. When assessing risk in a large single audit, the auditor shall consider whether weaknesses are isolated in a single operating unit (e.g., one college campus) or pervasive throughout the entity.

(ii) When significant parts of a Federal program are passed through to subrecipients, a weak system for monitoring subrecipients would indicate higher risk.
(iii) The extent to which computer processing is used to administer Federal programs, as well as the complexity of that processing, should be considered by the auditor in assessing risk. New and recently modified computer systems may also indicate risk.

(2) Prior audit findings would indicate higher risk, particularly when the situations identified in the audit findings could have a significant impact on a Federal program or have not been corrected.

(3) Federal programs not recently audited as major programs may be of higher risk than Federal programs recently audited as major programs without audit findings.

(c) Oversight exercised by Federal agencies and pass-through entities. (1) Oversight exercised by Federal agencies or pass-through entities could indicate risk. For example, recent monitoring or other reviews performed by an oversight entity which disclosed no significant problems would indicate lower risk. However, monitoring which disclosed significant problems would indicate higher risk.

(2) Federal agencies, with the concurrence of OMB, may identify Federal programs which are higher risk. OMB plans to provide this identification in the compliance supplement.

(d) Inherent risk of the Federal program. (1) The nature of a Federal program may indicate risk. Consideration should be given to the complexity of the program and the extent to which the Federal program contracts for goods and services. For example, Federal programs that disburse funds through third party contracts or have eligibility criteria may be of higher risk. Federal programs primarily involving staff payroll costs may have a high-risk for time and effort reporting, but otherwise be at low-risk.

(2) The phase of a Federal program in its life cycle at the Federal agency may indicate risk. For example, a new Federal program with new or interim regulations may have higher risk than an established program with time-tested regulations. Also, significant changes in Federal programs, laws, regulations, or the provisions of contracts or grant agreements may increase risk.

(3) The phase of a Federal program in its life cycle at the auditee may indicate risk. For example, during the first and last years that an auditee participates in a Federal program, the risk may be higher due to start-up or closeout of program activities and staff.

(4) Type B programs with larger Federal awards expended would be of higher risk than programs with substantially smaller Federal awards expended.

§___.530 Criteria for a low-risk auditee.

An auditee which meets all of the following conditions for each of the preceding two years (or, in the case of biennial audits, preceding two audit periods) shall qualify as a low-risk auditee and be eligible for reduced audit coverage in accordance with §___.520:

(a) Single audits were performed on an annual basis in accordance with the provisions of this part. A non-Federal entity that has biennial audits does not qualify as a low-risk auditee, unless agreed to in advance by the cognizant or oversight agency for audit.

(b) The auditor's opinions on the financial statements and the schedule of expenditures of Federal awards were unqualified. However, the cognizant or oversight agency for audit may judge that an opinion qualification does not affect the management of Federal awards and provide a waiver.

(c) There were no deficiencies in internal control which were identified as material weaknesses under the requirements of GAGAS. However, the cognizant or oversight agency for audit may judge that any identified material weaknesses do not affect the management of Federal awards and provide a waiver.

(d) None of the Federal programs had audit findings from any of the following in either of the preceding two years (or, in the case of biennial audits, preceding two audit periods) in which they were classified as Type A programs:

(1) Internal control deficiencies which were identified as material weaknesses;
(2) Noncompliance with the provisions of laws, regulations, contracts, or grant agreements which have a material effect on the Type A program; or

(3) Known or likely questioned costs that exceed five percent of the total Federal awards expended for a Type A program during the year.

**Appendix A to Part __ - Data Collection Form (Form SF-SAC)**

[insert SF-SAC after finalized]

**Appendix B to Part __ - Circular A-133 Compliance Supplement**

Note: The provisional "Circular A-133 Compliance Supplement" is available from the Office of Administration, Publications Office, room 2200, New Executive Office Building, Washington, DC 20503 and the OMB Home Page under the "OMB Documents", in the "Grants Management" section.
FINANCIAL MANAGEMENT FOR NON-PROFITS

MODULE #1: THINKING LIKE AN ACCOUNTANT

Part #1: Financial Framework: the basics

- The purpose of an accounting system is to record, classify and summarize business activity. An accounting system keeps track of where your money comes from and where it goes.
  - An accounting system should:
    1. Accurately reflect your organization’s current financial condition and do so in a timely way
    2. Be clear, logical and easy to use. Information should be understandable to management and the board of directors
    3. Provide useful information that staff and board can use in making decisions and achieving goals
  - The most important means of ensuring that your accounting system produces accurate information is to base it on a detailed Chart of Accounts that accurately captures the financial information you need for decision making and reporting purposes. The Chart of Accounts is a list of each item that your accounting system tracks in each of five categories: Assets, Liabilities, Net Assets, Revenues and Expenses.
  - You should also classify your expenses by functional areas, which allows you to track expenses for different organizational activities or programs. It is recommended that you establish “budget units” for the following costs: “Management and General”, different programs/projects (as many as needed), and Fundraising.
  - Your accounting system should also be set up using the Accrual-based method of accounting. This method provides a much more accurate picture of your financial condition by recognizing outstanding or accrued obligations (“bills”) and funder commitments or guaranteed income as “Payables” and “Receivables”.
Financial Reports: All organizations must prepare three basic ones:

- A Statement of Financial Position,
- A Statement of Activities, and
- A Statement of Cash Flow.

The Statement of Financial Position: is a snapshot of an organization’s financial condition as of a particular date, such as the last day of a month or a fiscal year. It summarizes the value of what an organization owns and what is owed to it (Assets), what it owes (Liabilities), and how much is left over (Net Assets).

Importantly, for non-profit organizations, Net Assets must be reported by three groups based on whether or not they have donor-imposed restrictions. These are:

- Unrestricted Net Assets,
- Temporarily Restricted Net Assets (these would include net assets resulting from CDBG and HOME funding), and
- Permanently Restricted Net Assets

Although most software doesn’t automatically handle the three categories of Net Assets, you can use a manual journal entry to reflect the required information. You may wish to consult with an accountant on helping you with this reporting requirement.

The Statement of Activities: summarizes financial activity over a period of time, such as a month or a fiscal year. It tells about an organization’s sources of income (Revenues)—how it is earned, how dependent an organization is on certain kinds of funding—and its expenditures (Expenses)—how much is spent on specific programs.

The bottom line of the Statement of Activities is a determination of the organization’s change in Net Assets resulting from its activities during the year, again by the same three categories as on the Statement of Financial Position (Unrestricted, Temporarily Restricted and Permanently Restricted Net Assets).
Statement of Cash Flows: shows the flow of “liquid” assets—investments with a maturity of three months or less—into an organization whether by cash or credit. The Statement must show:

1. Cash flows from operating activities, including net cash used by operating activities
2. Cash flows from investing activities, including net cash used by investing activities
3. Cash flows from financing activities, including net cash used by financing activities
4. Net increases or decreases in cash and cash equivalents
5. Cash and Cash equivalents at the beginning for the year
6. Cash and cash equivalents at the end of the year, including a reconciliation of changes in net assets to net cash used by operating activities

Some software can prepare this statement, however, it is imperative that accounts are appropriately categorized. Otherwise, it’s “garbage in, garbage out”. An accountant can assist you in proper classification of accounts. Additionally, while the other two statements are may be prepared on a regular basis, the Statement of Cash Flows is typically prepared annually (or several times a year, at most). This is a tricky statement to produce and most organizations would need an accountant’s help.

What are the three most important things an accountant looks for when reviewing these financial statements?

1. That they exist and are up to date and accurate
2. Changes in Net Assets
3. Changes in cash position

Smaller non-profit organizations typically have an accountant prepare these reports for them, based on information provided by the organization.
A fourth important issue from an accountant’s point of view is that an organization has prepared an annual budget and compares actual-to-budgeted expenses and revenues on a regular basis, ideally monthly.

- **A Budget is an organization’s plan of action for the year translated into financial terms.** The annual budget should be prepared with the involvement of board members and they must satisfy themselves that revenues will be adequate to meet project expenses. Serious errors in the budget’s plans for income and expenses can prove devastating to an organization. The important issues surrounding the budget include:
  1. That it is prepared and presented in a timely way
  2. That budget assumptions are realistic
  3. That specific types of revenue and/or expenses will not jeopardize the organization’s tax-exempt status
  4. That the cash management to account for the ebb and flow of funds has been addressed
  5. That contributions are properly accounted for within the budget
  6. That indirect costs associated with supporting activities are justifiable in light of total program expenses
  7. That there is sufficient detail to allow for comparison with actual results during the year
  8. That projected programs’ expenses as a percentage of total revenues are reasonable

- In working out an initial budget, it is often helpful to slightly overestimate expenses and slightly underestimate revenues. It is also prudent to include a line item for Contingencies/Reserves.
Another major concern of an accountant is the **system of internal controls**, or mechanisms and/or procedures that protect an organization against theft or misuse (either intentional or unintentional) of money or assets by employees.

- Some internal controls dictate how money is handled within an organization to ensure that it is be safely received, recorded, and/or deposited and then expended in an appropriate manner. Cash receipts and cash disbursements are the two primary areas of concerns.
  
  - Instituting a system of internal controls is one of the biggest problems for small organizations with 1 or 2 staff.
  - With only 1 or 2 staff, it is recommended that a board member, such as the Chairman or the Treasurer, be involved in the system by doing the bank reconciliations and countersigning checks over a minimum amount, say $500.
  - Another system non-profits should have in place is a process to acknowledge contributions from individual contributors seeking a tax-deduction. It is good practice to acknowledge and thank donors contributing any amount, however, the law requires that contributors giving $250 or more be provided with a written receipt. Additionally, for donors receiving some form of goods or services (i.e., a coffee mug, a meal, etc.) in connection with a donation, special written acknowledgments indicating the fair market value of any item or service received by the contributor (which must be deducted from the donation amount) must be provided for contributions of $75 or more. All acknowledgments should include the amount and restrictions placed on the contribution by the contributor and its relative deductibility.
  
- Other areas of internal controls include property and equipment records, personnel policies, insurance, record retention, and physical controls and security (locked and fireproof filing cabinets, back-up tapes with off-site storage for computer files, etc.).
Part #2 Compliance

- Audits, are equally important concerns of accountants, and should be carried out annually by organizations, regardless of whether they are required by funders. Having an annual audit is one of the most important ways you can demonstrate your accountability to funders, donors, and the public, and is a sound financial practice.

- Audits in general: An audit consists of various procedures an independent auditor may use to test transactions and internal controls so as to form an opinion on the “fairness” of the presentation of the organization’s financial statements (Statement of Financial Position, Statement of Activities, and Statement of Cash Flows) for the period covered by the audit.

- The goal of an audit is to determine whether these statements have been prepared in conformity with generally accepted accounting principles.

- An audit does not examine every financial transaction. Instead, it is a series of tests conducted to allow the auditor to determine how effectively the records were kept and how reliable the organization’s internal controls are. The results of the tests permit the auditor to express an opinion on the financial position of the organization, as a whole, as reflected in its financial statements.

- Importantly, an audit is not designed for the purpose of uncovering “wrongdoing”. Because all transactions are not examined during an audit, an audit cannot be relied on to detect fraud or other irregularities. The auditor can assist management in meeting its responsibilities for safeguarding assets by suggesting improvements in the internal accounting controls and procedures to reduce opportunities for errors and mishandling funds.

- The product of an audit is the Auditor’s Report. This has:
  1. An introductory paragraph emphasizing that the client is primarily responsible for the financial statements and the opinion is rendering a report on the financial statements, not on the accounting records.
  2. A scope paragraph describing the nature of the audit, that it was done in accordance with generally accepted auditing standards and provides reasonable assurance that the financial statements are free of “material” (important enough to change an investor’s decision) misstatement.
3. An **opinion** (not a guarantee or certification) paragraph that financial statements are “presented fairly”.

- The auditor may also provide a separate Management Letter. This is not required and can be verbal. It is in this letter that an auditor may make suggestions for improving the organization’s financial system. It is a good idea to ask your auditor for a Management Letter.

- Finding an Auditor: your auditor should be someone who understands the unique characteristics of non-profit accounting and auditing. (Ask them how many of these types of audits they have done, ask other nonprofits who they use, etc. Importantly, your auditor **cannot be someone** who provides you with significant non-audit services throughout the year. These services can include such things as maintaining your official accounting records, coding, preparing, and posting transactions, and/or maintaining control of your assets (i.e, bank accounts, etc.). In other words, an auditor cannot audit their own accounting work and must be “independent” in all matters of the audit.

**Compliance with Federal Regulations:** The ultimate responsibility for the financial management of Federal funds rests with the grantee (in the case of CDBG and HOME funding, the State of Nebraska). This means that grantees must hold subrecipients and administrators of Federal funds to the same standards, restrictions, and requirements that they must meet.

- These standards, restrictions, and requirements are found in several places: Congressional statutes, Federal Agency Regulations, Office of Management and Budget (OMB) circulars, and Generally Accepted Accounting Principles. Of particular importance are three OMB circulars: OMB Circular A-110, OMB Circular A-122, and OMB Circular A-133.

- **OMB Circular A-110:** “Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals and Other Non-Profit Organizations” sets forth standards for obtaining consistency and uniformity in the administration of federal grants by non-profit organizations. It prescribes pre-award, post-award and closeout requirements. This circular prescribes standards for financial and program management, property standards, procurement standards, reports and records, and termination and enforcement.
A-110 dictates that non-profits using federal funds must keep accurate records, which means that they must have a financial management system (controls and source documentation) that can track costs by project.

Two of the most important of the procurement standards are:

1. That there be no real or perceived conflicts of interest in the award or administration of Federally funded contracts.
2. That the procurement policies be written. These policies would include procedures for competitive bidding to ensure that an organization pays the “best possible prices” for items or services procured. This is especially true for purchases over $25,000.

Another important provision of A-110 is records retention. Financial records, supporting documents, statistical records, and all other records pertinent to an award must be retained for a period of 3 years from the date of submission of the final expenditure report. For CDBG awards, the retention period is 4 years; for HOME awards, the retention period is 5 years.

Also important is the treatment of property and equipment purchased with Federal funds. The most important feature in this section is that nonprofits have a listing of all equipment owned and that a periodic count or other procedure is performed to check the listing. Approval of the funding agency is also needed to dispose of real property (unless disposal was intended within the program, as with acquisition/rehabilitation/homeownership programs), encumber real property with debt, use it in any other way than the original purpose or to trade-in or sell equipment.

OMB Circular A-122: “Cost Principles for Nonprofit Organizations”, establishes the principles by which federal agencies determine the costs of work performed by nonprofit organizations under awards. The principles are designed so that the federal government bears its fair share of costs except where restricted or prohibited by law. The most important considerations in this circular are that the costs be allowable (eligible), allocable, and reasonable.

A-122 provides that costs must be allocated to the grant or project in accordance with benefits received. They can be either direct (those incurred specifically to implement activities allowable under a particular award) or indirect (those incurred that benefit both the
award and other work of the organization, not readily identified with a particular objective).

- An organization can use one of several prescribed methods for allocating indirect costs to a particular program or project. However, in order to charge indirect costs to a Federal award an agency must prepare an indirect cost rate proposal and have it approved by its cognizant Federal agency (with CDBG and HOME, this would be HUD).

- The following costs are never allowable with Federal funds: the purchase of alcoholic beverages, bad debts, entertainment costs, and lobbying activities.

OMB Circular A-133: “Audits of States, Local Governments, and Nonprofit Organizations”. This circular governs a special type of audit, which is required of all nonprofit organizations expending $300,000 or more in Federal funds in a fiscal year.

- Federal funds expended include those combined from all sources (agencies, such as HUD--directly or as passed-through DED, USDA/RD, etc.) and all types (i.e., grants, loans, loan guarantees, property, insurance, etc.).

- An A-133 Audit, often called a “Single Audit”, involves much more than a detailed review of the nonprofit’s financial statements and financial controls (as described earlier). It also includes a testing of the nonprofit’s compliance with certain federal laws and regulations and with the terms of its award agreements.

- A-133 also covers other compliance requirements including Davis Bacon wage rates, real property acquisition and relocation assistance, political activity, civil rights, and drug-free workplace requirements.

- It is the responsibility of an organization to: (1) determine if it has spent $300,000 or more in Federal funds (from all sources) in its fiscal year; (2) arrange for the A-133 audit if required; and (3) submit the completed audit to the Federal Clearinghouse and a copy of the audit to the applicable pass-through entity (if there is one).

- The most important issue involving A-133 audits is selecting an auditor who knows both nonprofit accounting and is qualified and/or certified to carry out this type of audit. Again, your auditor cannot
be someone who has provided significant non-audit services to you throughout the year.
 MODULE #2: THINKING LIKE A BUSINESS OWNER  

Part #3: The Nonprofit as a Business

Is there a difference between running a non-profit vs. a for-profit business? What’s different, what’s the same?

- Both are “providing” (selling) a product or service, whether it be widgets in the for-profit world, or affordable housing for low and moderate income households in the non-profit world.
- Both types of businesses want to turn a “profit” (although this term isn’t used in the non-profit world). The for-profits to financially benefit or reward owners or stockholders, the non-profit to continue to carry out their mission.
- Both must operate with sound financial management practices.

How does a small organization afford good financial management?

- Find someone with non-profit accounting expertise to help you set up your accounting system. Ask if it is possible for them to volunteer or donate time, or provide services at a reduced fee. This person can help you set up your Chart of Accounts, establish a system to track expenses by functional areas, explain how to code transactions (this can be tricky, especially for organization’s involved in housing development), establish a system of internal controls, and help you prepare financial statements and budget reports. Again, however, it is important to remember that an accountant that has too much control over your financial management and accounting system cannot do your audit.

  Some organizations may just use (or need) an accountant to prepare their financial statements and budget reports based on information they provide.

- Invest in a good small business accounting software program. These programs are inexpensive, user-friendly, and can provide every financial report any organization needs and then some. The most important issue here, however, is bookkeeping entries. These must be absolutely accurate or reports generated by the software won’t be worth the paper they are printed on. Bookkeeping entries should be done in-house, if possible. It’s expensive to contract out, but more importantly staff needs to understand the information. (The more staff uses it, the more they will come to understand it.) And it must be up-to-date, or it is useless.
• **Contract out payroll functions.** The rules are complicated; making a mistake is serious business with serious consequences; and there are individuals or firms who specialize in this work available to every community (although not necessarily located in every community).

➢ **What is the role of the Board in a small nonprofit environment?**

• In a non-profit organization, board members represent the interests and needs of the public at large as well as those of the particular constituency the organization is pledged to serve.

• By law, the board is responsible for determining an organization’s mission and for setting policies for its operation. Therefore, it must draft, approve, and amend, as needed, two important documents: the Articles of Incorporation and the bylaws. It also insures that the organization’s charter is being followed.

• Since nonprofits receive a generous public subsidy because they are tax exempt, board members need to ensure that the public purposes of nonprofit organizations are in fact being carried out. This means that board members have a **fiduciary responsibility** and are answerable to the government agencies that regulate and monitor nonprofit corporations.

  □ This also means that board members need to make sure that the organization is filing required reports (i.e., IRS Form 990, state forms, etc.) annually so that the organization retains its non-profit status.

  □ Additionally, if the nonprofit is certified by the state as a Community Housing Development Organization (CHDO) under the HOME Partnership Program, the board must follow the statutes and regulations governing that program.

• Also of critical importance, board must adopt a **formal policy** on conflict of interest by board members.

• Board members are also ultimately accountable for the responsible and prudent use of the nonprofit organization’s money and other assets. For this reason, board members should be involved in the development and monitoring of the **annual budget**.

• Board members also are usually expected to participate in **fund-raising** activities for the organization. Most small nonprofits are undercapitalized; therefore, this becomes a very important part of the board’s duties.
• In terms of **financial management**, board members can provide the sorely needed internal controls often missing from small organizations. At a minimum, the Treasurer (or Chair) should reconcile the bank statements once per month. And the Chair should work with the auditor, paying particular attention to issues raised in the Management Letter (which should always be requested of an auditor).

  - It is also the Board’s role to establish financial policies (three important ones include: never sign a blank check, establish a maximum amount for one signature checks, and do not allow the director to sign a check made out to him or her) and to be involved in selecting an accounting firm to do the annual audit.

**What should the Board expect to hear and see on financial issues at monthly meetings?**

- The financial reports at each meeting should include: a Statement of Financial Position, a Statement of Activities with comparisons to the annual budget, and a year-to-date budget report.

- At a minimum, the budget report should show a comparison between the last year-to-date and current year-to-date of the adopted budget, actual revenues and expenses, and projected revenues and expenses to the end of the fiscal year. Major discrepancies should be explained.

**Before agreeing to serve on a Board, what questions might prospective Board members ask the current board and/or staff?**

- In addition to the typical questions a prospective Board member might be concerned about, such as mission and what particular skills and commitments they are looking for from Board members, diagnostic financial questions center around three issues:
  1. Are the books up-to-date and the bank statements reconciled?
  2. What are the typical cash disbursements and what controls exist to protect against mismanagement?
  3. Is there any payroll tax liability outstanding? One of the quickest, simplest ways to check an organization’s stability (financially or in terms of good overall management) is to determine if they are current on paying payroll taxes: Social Security and Medicare (FICA) taxes, federal unemployment tax (FUTA), and state and federal income taxes. Regardless of the timeframe of a nonprofit’s fiscal year, it must pay and report these taxes within the January 1 to December 31 time period.
Part #4: Getting Healthier for the Long Term

- Now that you are doing things “right” in terms of financial management, it’s time to find the “right” things to do.
  - Many nonprofits fall into the trap of following the money trail; they determine their mission not on the basis of a strategic plan that makes sense in terms of the communities they serve or skills of the staff or board, but on the basis of sources of funds they can secure through grantsmanship.

- How do you start finding the right things to do?
  - The process should begin with a needs assessment in your geographic area of operations and an identification of the potential resources (human and financial) available to meet those needs.
  - For organizations operating programs or developing projects, the process should also include an analysis of current programs’/projects’ successes and challenges.
    - Staff, board, and outside members of the community to be served need to be part of the needs and resources identification; staff and board members should be part of the evaluation of existing programs and determination of appropriate goals.
  - The next step is to establish the short term and longer-term goals for the organization. These goals should be Specific, Measurable, Achievable, Relevant, and Timely (SMART).
    - The goals should address both outputs (i.e., # of units produced, # of loans closed) and outcomes (increased customer satisfaction, revitalized neighborhoods). Outcome measurement is much more difficult to achieve, but if the public “balance sheet”—changed lives of the people we serve and changed communities we operate in—are to be achieved, outcomes are important considerations.

- Once you have completed your needs assessment and evaluation of existing programs, you should prepare your annual budget accordingly. Staff and board should address the following questions:
  1. Should we maintain the status quo?
  2. Should we grow by adding new programs or increasing production of existing programs? How will this affect staff and resources?
3. Should we specialize in certain types of programs that match community needs, available resources, and staff skills?

4. Should we contract out some of the activities we are doing to increase efficiency?

5. Are there new partnerships we should be pursuing that can leverage our dollars and our staff skills?

- Only after all of the above activities are completed and questions answered can a realistic budget be prepared.

- Important to keep in mind is that a budget is not a static document. It must be continually reviewed, preferably on a monthly basis, to insure that assumptions made at the beginning of the year were realistic.

- The above activities also serve another important function: they are a message to funders, both existing and potential, that the organization is a healthy one and can spend the public’s money efficiently and effectively. It can also clearly make the case for a continuous, dependable supply of funding for the long term.
MODULE #3. THINKING LIKE AN INVESTOR

Part # 5: Who are your Investors?

➢ First of all, let’s define the term “Investors”. For our purposes, let’s say that an investor is someone who “gives you something in order to earn or gain something”.

❑ What is the “something” that an Investor can give you? Well, at the top of the list is probably money (either granted or loaned). However, there are other contributions an Investor can make: buildings or land, volunteer time and/or expertise, donated materials, space, and/or staff time,

❑ What is the “something” that an Investor wants to earn or gain? In order to answer this question, we should look at the investor’s motive for investing. Here, a variety of factors can come into play and sometimes an investor may have more than one motive or reason for investing. For instance:

▪ Some investors want a financial return on their investment (i.e., loan payments with interest, tax deductions, etc.)

▪ Some investors want you to help them meet their mission, their “reason for being”. This is an over-riding concern of government entities and private foundations. For instance, government agencies want to fund successful projects that help a lot of people which will strengthen their case for continued funding from Congress (or state legislatures, etc.).

▪ Some investors want the “good press” that helping you will give them.

▪ Some investors are only interested in the “spin-off” effects that your organization’s projects or programs may have on other things.

▪ Some investors may get personal satisfaction from helping your cause. This is usually the case with private individuals who donate money, time or expertise to an organization. They believe that your mission is a good one and feel good by helping.

❑ There also can be other factors influencing an Investor’s decision to invest. Some want to make only no or low risk investments, some may want
control of some aspect of your program, some may even be acting from a personal point-of-view (i.e., their job depends on their making a loan).
There are a variety of entities that invest in nonprofits organizations; they can be categorized as: (1) Governmental and quasi-governmental—federal, state, regional and local; (2) Private entities, including other non-profit organizations and for-profit businesses, such as banks; and, (3) Individual charitable donors.

- Federal government investors include:
  - Federal agencies, such as the U.S. Department of Agriculture Rural Development (USDA/RD); the U.S. Department of Housing and Urban Development (HUD)—either directly or from a pass-through entity such as the Nebraska Department of Economic Development; the U.S. Department of Health and Human Services, and others.

- State government investors include:
  - the Department of Economic Development.
  - the Nebraska Investment Finance Authority (quasi-governmental entity).

- Regional investors include:
  - public power districts and economic development districts.

- Local government investors include:
  - Cities or counties [through LB480 option, Tax Increment Financing (source of funds to carry out public improvements associated with developments), land donation and other mechanisms].

- Private investors are numerous. Examples are:
  - Local lenders that will access programs of the Federal Home Loan Bank of Topeka
  - Local lenders that will make favorable loans to meet CRA obligations or that have or can access bank foundation monies
  - Local businesses
  - private entities that provide equity to housing projects in return for tax credits
  - Private foundations: national, statewide, regional, or local
  - Private individuals who will donate money, time, expertise and more
What do investors want or expect from your organization? **Investors want, first and foremost, to be assured that an organization is going to stay in business.** They want to see more than a marketing brochure. They want to see your plan; they want to see a budget that matches that plan; they want to know that your public “balance sheet” is a strong one, and they want to know that your financial house is in order.

Investors may want to see your financial statements, audits, and tax returns. They may want to tour your projects (actually a tour may be a good idea), hear testimonials, get references, and review qualifications of staff that will carry out the project. What is your organization’s track record?

Besides knowing that your financial house is in order and that you have based your activities and budget on a thoughtful strategic plan supporting your mission, what do the various categories of investors focus on:

1. For **government investors**, especially federal, the emphasis is on **compliance**. Although they are concerned with performance, they are more interested in a nonprofit following the statutes and regulations of the federal funding source and OMB circulars.

2. For **foundations and charitable investors**, **performance** is very important and the only compliance issue they focus on is making sure the organization is a 501(c)3.

Lastly, Investors want results. They want to see a “product”. They want to know that their investment turned into a successful project, and that they made a difference somehow.
Lecture # 6: Partnering to Enhance Capacity and Reduce Risk

- Most nonprofits in Nebraska are small operations, sometimes with only one or two staff. How is it possible for such limited staff to perform all the duties required to keep an organization in business?
  - They must manage finances, internal operations, and programs with all the requisite compliance issues we have covered in this course. They have to educate and support the board. They have fundraising and public relations duties. The director probably also has personnel management responsibilities. One way is to form partnerships with others.

- Some organizations, especially early on, find that they are just getting by on the “skin of their teeth”. They have too little continuous funding to support and/or keep qualified staff, and they have too few staff to expand programs and services. They’re caught. Between a rock and a hard place.

- The most important activity an organization can and must perform in finding and evaluating potential partners is to identify its own strengths and weaknesses and those of its potential partners in order to sort out roles and responsibilities each could assume.
  - In assessing your strengths and weaknesses, take a “brutally honest” approach. For instance, in light of your present/ projected organizational capabilities and the needs/resources in your area, what must you have to continue as a viable organization? Areas for assessment could include:
    - Funding
    - Staffing
    - Facilities
    - Expertise (both organizational and programmatic)

- The word partnership implies sharing or joining together for mutual benefit or benefits. This means that a partner is not typically an investor, although the line between partner and investor is sometimes blurred. Also, investors (HUD does this) often call themselves “partners” because it sounds warm and fuzzy.

- Potential partners can generally be divided into two categories: general organizational partners and program/project partners.
  - Organizational partners are those that can help you carry out your overall mission
  - Program/project partners are those that can help you carry out specific programs or projects
What could be some of the outcomes of partnerships?

- Reduced overall organizational expenses from sharing staff, sharing office space and/or equipment, etc.
- Lowered costs or expanded programs and services by combining staff and expertise
- Increased ability to secure funding by creating a broader base of support (yours plus your partners) and improving your “marketability” to funders/investors
- Expanded assistance to your clientele in accessing additional programs

How does an organization find such partners?

- First of all, potential partners will generally be entities that operate within, or close to, your organization’s area of operation. (It’s difficult to have a long-distance partnership.)
- Identify other entities in your area that could be stakeholders with you in your mission. For instance, if your mission is to provide affordable housing, the community (government), region, local merchants and employers, the chamber of commerce, local lenders, could all benefit if you succeed.
- Are there other organizations similar to yours (for example, non-profit, human-service or housing-related) and geographically close enough to form partnerships with? Is there a public housing authority in your area?
- Don’t step on anyone’s toes. Partners work together for mutual benefit.
- Sometimes forming partnerships requires a good deal of finesse, marketing and self-promotion, and salesmanship and time to “court” your potential partner. However, even the smallest organizations have “something” to offer a partner, although this may not always be readily apparent.
  - One example, a small nonprofit that needs help with bookkeeping but doesn’t have the resources to pay for this service, could approach the home town lender and ask for help. Bank staff could provide this service get CRA credits, and by strengthening the organization (reducing their costs and increasing their efficiency) would be strengthening the local economy (in turn, more loans, deposits, etc.).
  - Scenario 2. The local lender turns you down. So you approach the local branch of the out-of-state financial institution in your town. Same spiel with maybe more emphasis on CRA. Also, the non-profit would say
great things about the bank, put its name on promotional materials as a supporter, etc.

- **Sometimes Partners come to you.**
  - Be open to these opportunities. For instance, private for-profit developers who build affordable housing generally need non-profit organizations as partners.
  - Local governments with affordable housing as a community development goal/strategy also need someone to sponsor/develop this housing.

- **Who should approach a potential partner?**
  - Making that first phone call to identify the right organization and the right person in that organization to approach is often the hardest step. Brainstorm with your board and supporters. Who do they know, or who do they know that knows someone, etc. Determine who is the best person from your organization to take that step and develop a strategy for approaching them. Explain the mutual benefits that could come from a partnership and describe how you see the partnership working (who does what).

- **Establishing a partnership can be formal or informal.**
  - Roles and responsibilities of each partner should be clear at the outset and set forth in a written agreement. However, some written agreements can be more formal than others, ranging from Memoranda of Understanding to legal contracts. For instance,
  - A partnership with the local government to work together to develop affordable housing could be set out in a Memorandum of Understanding. Will the “city” help to find land, provide infrastructure, etc.?
  - In partnerships with private developers, it is incumbent on your organization to understand the tax credit process and establish at the outset of the process the exact role you will play (is it “smoke and mirrors” or are you a working partner?). What payment will your organization receive from the project? Will you assist the developer in overseeing construction? Will you provide management services to the project? Etc.
  - In the extreme, a partnership to merge with another non-profit, could require re-incorporation, and new Articles of Incorporation and by-laws.

- Even forming partnerships cannot address all the resource limitations facing small nonprofit organizations. All organizations have to make choices, put
those choices in priority, and set realistic goals about their activities. This underscores the importance of strategic planning.
A small Nebraska non-profit has two programs for which it has received on-going funding:

- A HOME-funded owner-occupied rehab forgivable loan program ($60,000/year of which $10,000 is permitted for program administration), and
- A HOME-funded rehab program for new homebuyers ($100,000/year).
- The State also has provided the organization with an operating grant in the amount of $20,000 a year for the past three years.

Staff and board turnover has limited production under both programs, causing overhead costs to rise as a percentage of gross income. Also, the previous part time director attempted to save money by doing the bookkeeping herself, using Quick Books, and partially donated services by a local accountant to do the audits.

Last year, the State funding agency did a monitoring visit and found some record keeping deficiencies, in particular with regard to documenting costs. The new director received board permission to spend $3,000 on a new, outside audit of the past two years of records of the organization.

Although there were no formal audit findings, the new auditor’s management letter to the board outlines the following findings:

- questions regarding the policy of allowing staff’s personal expenditures on the organizational credit card
- observation that there is no policy in place regarding vehicle use
- determination that a computer was purchased without properly documented bids (procurement)
- notes that the cash method of accounting currently used fails to accurately define the organization’s change in Net Assets (Revenue minus expenses) at the end of the year, which was listed at $21,433 when it actually was $13,567
- Management and General administrative costs have not been separated from new business/marketing costs
- notes that last year’s books showed a $30,000 carryover from a previously unexpended HOME grant, which is now completed. No firm date is indicated for renewal.
Questions:

1) How serious are these deficiencies? Which ones are easily correctable, which ones reflect more systemic problems with the organization?

2) Which deficiencies reflect problems with basic organizational record keeping and policies, and which might lead to Federal monitoring and compliance problems which could result in demands for repayment of Federal funds?

3) What other problems might this organization have that have not been uncovered by the audit and State monitoring visit? Where would you look in the organization’s records to find evidence of such a problem or verify that no problem exists?
Exercise 2: *A Place for Everything and Everything in its Place*

As a result of last year’s audit, the board of the non-profit and its new director look more closely at the performance of the organization in executing its Federally-funded programs six months into the current year. This review starts with the program funded under the first HOME grant:

- The owner occupied rehab forgivable loan program has been in operation for 6 years. Typically, 6-10 loans a year averaging $8,500 per loan are completed. Last year, however, 7 loans were done. Because the program is set up as a forgivable loan over seven years, there is no program income unless a house is sold before the expiration of the loan term. Earlier this year a house was sold, and $4,000 in proceeds was returned as program income. The $4,000 was improperly credited to the “Management and General” account and expensed during the course of the year. When that income is properly reposted to the HOME program account, HUD rules on program income require that it be spent on eligible program activities.

In addition to solving this bookkeeping problem, the board would like to explore ways to cut administrative costs for this program, increase program income, increase the number units produced in the next year, and secure funding in a like amount (or higher) from the State.

Questions:

1. The easiest way to resolve this program income mis-posting problem is to:

2. With regard to the rest of the board concerns, what is the responsibility of the board and what is the responsibility of the director in addressing each item?

   - Cutting administrative costs

   Board                     Director
• Increasing program income
  Board Director

• Increasing unit production
  Board Director

• Securing ongoing funding
  Board Director
The board decides it must do the following to address two critical problems:

1. find ways to build a reserve of at least $50,000 to cushion income shortfalls and meet needs for working capital,
2. find a new source of program income beyond the current two program activities. It determines that $250,000 total income a year is the level it needs to support an additional ½ time person and stabilize its administrative operation. This is $50,000 more than current levels of program funding and activity.

The apparent choices for expansion are:

- Expand the HOME funded program to include loans to owners of rental properties in need of repair
- Joint venture with the local PHA or a regional for profit developer to build a 20 unit assisted living facility
- Market administrative support services to small cities in the area that apply for infrastructure funding under HUD or USDA programs.

Questions:

1. What would be necessary to successfully undertake an effort to raise funds to rebuild the organization’s reserves? How would you go about it? What would the organization have to have in place (that it does not now) in order to have a good chance of success?

2. What are the strengths and weaknesses of the three income generating ideas?
   - Expand HOME program to rental properties
• Joint venture on new assisted living property

• Provide administrative services to small cities in overseeing Federal funds.

3. What should the “client/funder” in each of these three scenarios want to know about the capabilities of the CHDO?

• HOME funding agency

• Joint venture developer partner

• Small municipalities in need of contract administration help