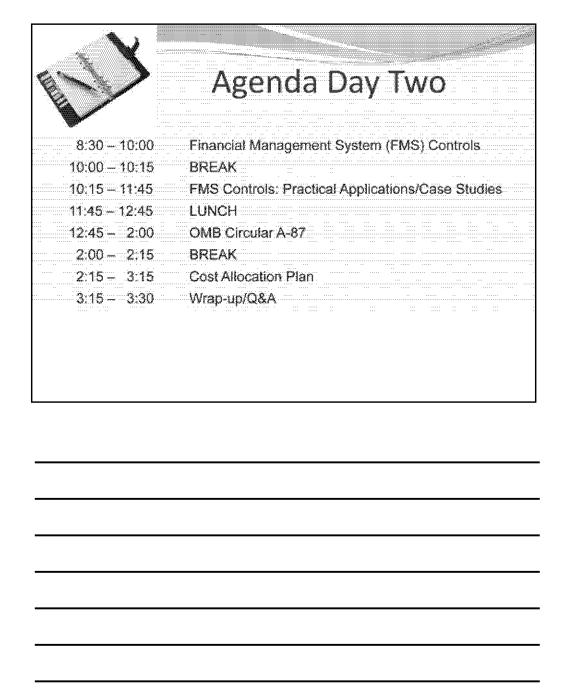
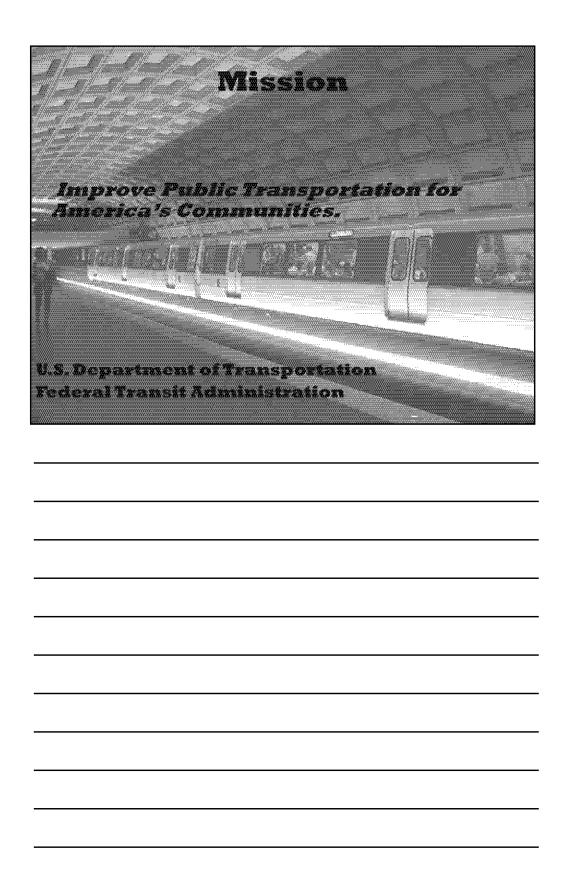


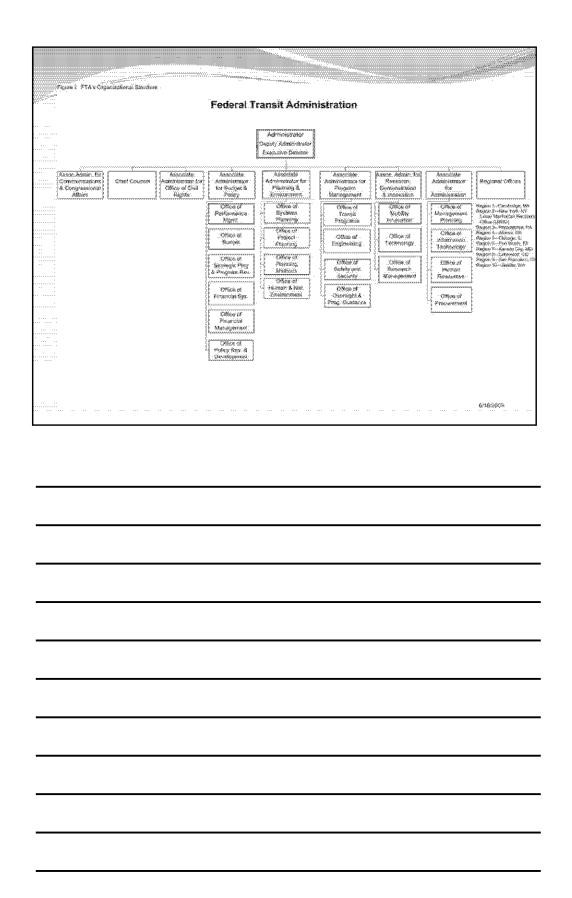


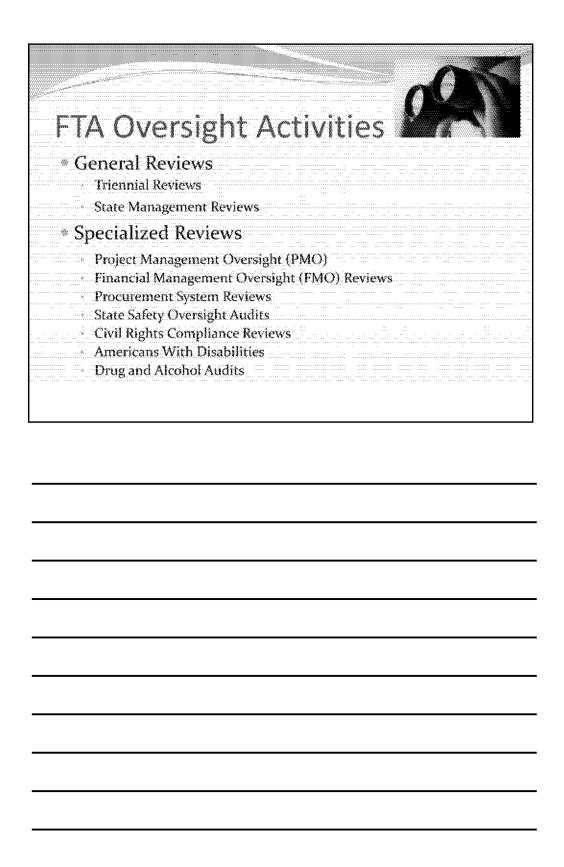
	<b>)</b> A	genda Day One
	8:30 8:45	Opening Remarks
	8:45 - 9:15	Course Objectives/ Introductions
	9:15 - 10:00	OIG Presentation/ Q&A
	10:00 -10:30	FMO System Review Process
	10:30 -10:45	BREAK
	10:45 -11:15	Grantee Regulatory Environment
	11:15 –12:00	Common Rule
	12:00 - 1:00	LUNCH
:	1:00 - 2:30	FTA Circulars – Part I
	2:30 - 2:45	BREAK
	2:45 - 4:30	FTA Circulars – Part II
::	4:30	Wrap-up

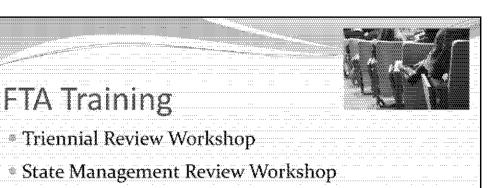




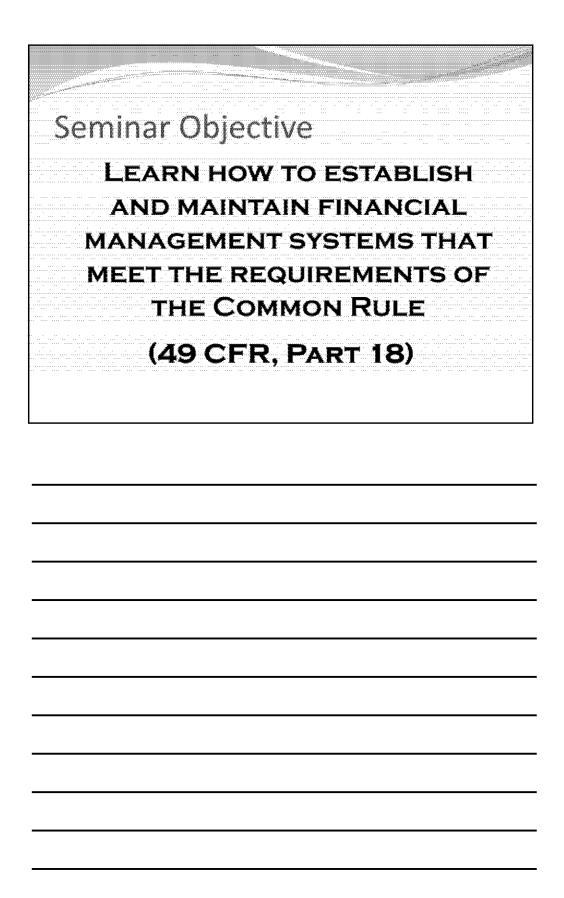
## FTA Activities Planning & Financing Grants & Financing Legislation, Regulation & Guidance Research, Technical Assistance & Training Civil Rights & Accessibility Reports & Publications \* Safety & Security American Recovery & Reinvestment Act (ARRA)







- Financial Management Oversight SeminarProcurement System Review Workshop
- National Transit Data Base Seminar
- Drug and Alcohol Training Programs



Linda M. Barnes
Manager, Financial Management Oversight (FMO) Program
Ms. Barnes has over 30 years experience with the
Federal Department of Transportation. She has
managed both the Triennial and State Management
Review Programs. Ms. Barnes is located in FTA Office
of Program Management, Washington, DC

Instructors  John Milligan, CPA, Managing Principal, Milligan & Co., LLC  Mr. Milligan started the firm in 1985. Prior to 1985, he worked for nine years at PriceWaterhouseCoopers (formerly Coopers & Lybrand.) Mr. Milligan has performed various special reviews for the FTA, in participating in various financial capacity reviews, and worked on the Best Practices and Procurement  System Review manual.	
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worked on the Best Practices and Procurement	
System Review manual.	
	 System Review manual.

## Instructors James W. Reid, CPA, MBA, Managing Director Reid Consulting, LLC James Reid founded Reid Consulting, LLC in 2001. In 2006, the firm was selected as a prime contractor under the FMO contract. Since that time, Mr. Reid has served as Engagement Partner on FMO Seminars, FMO fullscope reviews, cost allocation plan reviews, agreed-upon procedures reviews, and financial capacity assessments.

استوران		
	<b>1STRUCTORS</b> Donna McCoy, CPA, Senior Manager,  Milligan & Co., LLC	
	Ms. McCoy is currently a senior manager at Mil Co., LLC. She has over 16 years of diversified accounting experience. Prior to joining Milligan LLC, she worked at PriceWaterhouseCoopers f years. Ms. McCoy has served as manager for FMO reviews. Ms. McCoy has also performed	public & Co., or three
	specialized assignments for the FTA.	

# Senior Consultant/Project Coordinator Janisha Richardson, Reid Consulting, LLC Ms. Richardson is currently a Senior Consultant and Project Coordinator at Reid Consulting, LLC. She is Project Coordinator for the Federal Transit Administration (FTA)/Financial Management Oversight (FMO) Seminars. Ms. Richardson performs logistical coordination and contract negotiation with hotels, conference centers and other meeting facilities. She is also responsible for facilitating the on-site management of the two-day workshop.

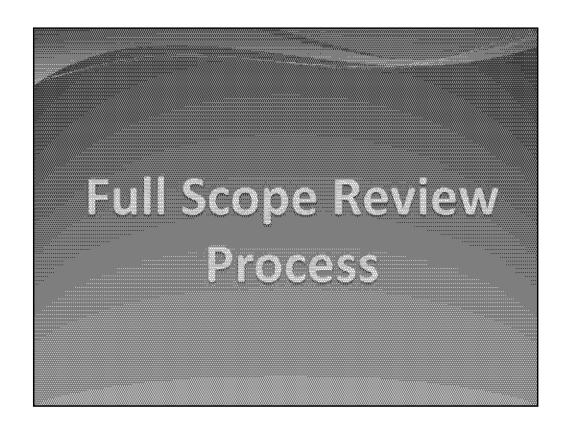
Introductions	
My name is	



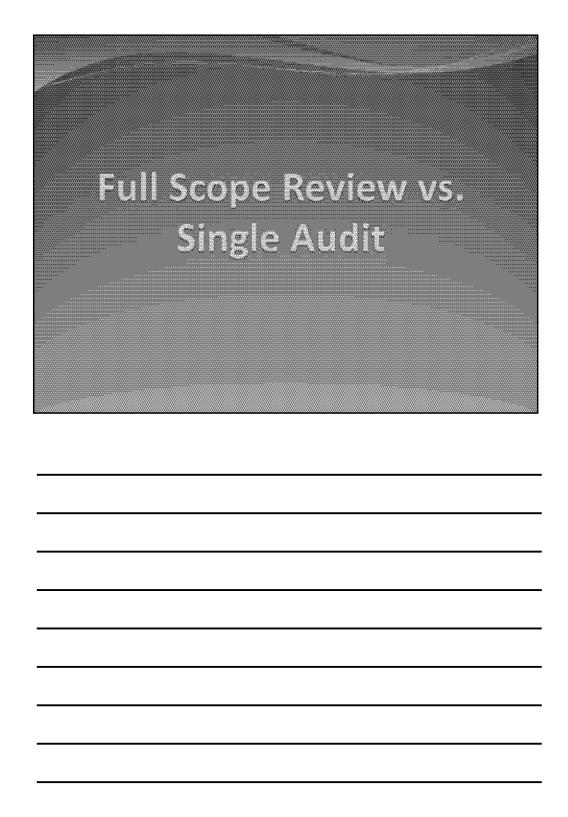
# Financial Management Oversight (FMO) Program

- ■Initiated 1991
- Contractor-Assisted Program
- Following IndependentProfessional Standards

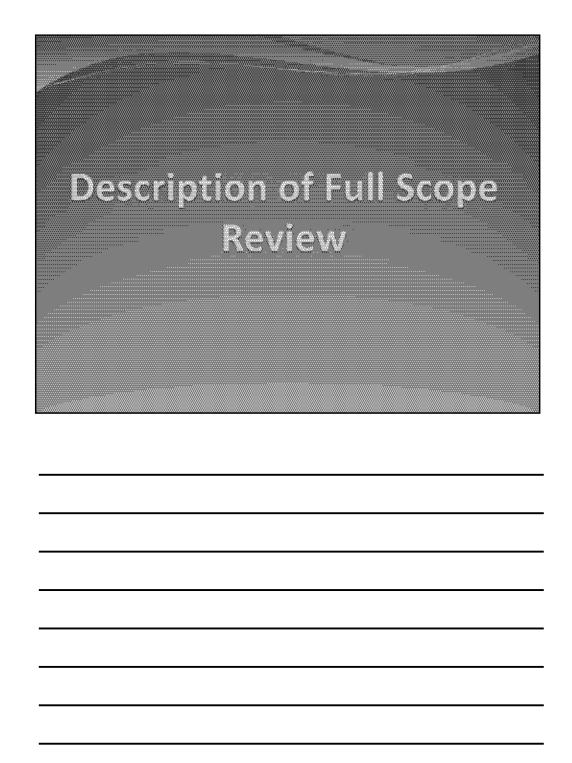

# Financial Management Oversight (FMO) Program **Types of FMO Reviews** Full Scope Systems Review Follow-up Review Cost Allocation Plan Review Special Assignment



# **Full Scope Process Overview** Full Scope Review vs. Single Audit Description of Full Scope Review What Constitutes a Financial Management System?



#### Full Scope Review vs. Single Audit Single Audit **Full Scope Review** Scope All Federal Expenditures FTA Grants Expenditures Audit of: Financial Statements Internal Controls/Compliance Internal No Opinion Opinion Controls Compliance | With Laws & Regulations Compliance with for Financial Statement Common Rule and Impact FTA Circulars Materiality Based on Total Federal Based on FTA Grant Expenditures Expenditures



### Description of the Full **Scope Review Process** Regional Desk Review Assessment phase (1 week) Testing phase (2-4 weeks) Reporting phase Draft Report Grantee Response Final Report

#### Description of the Full Scope Review Process

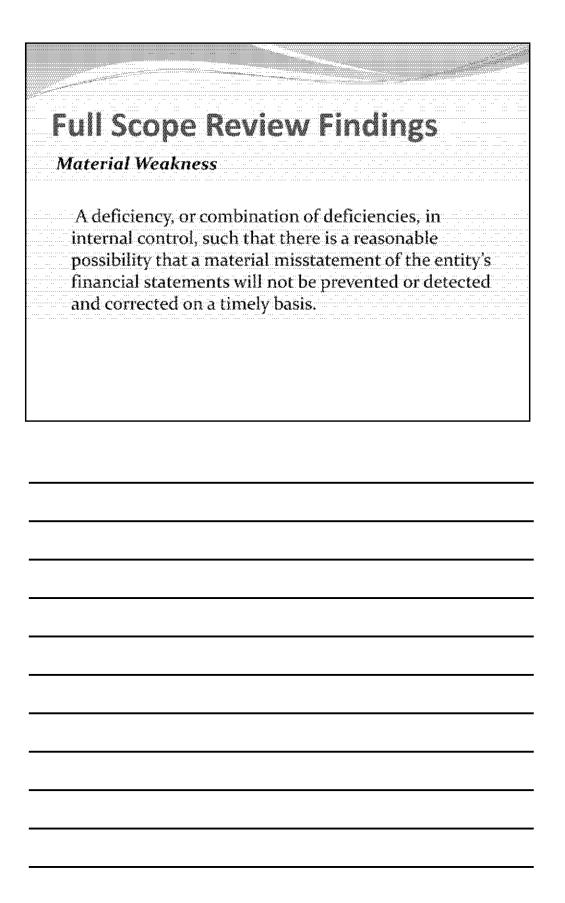
#### Reporting Phase

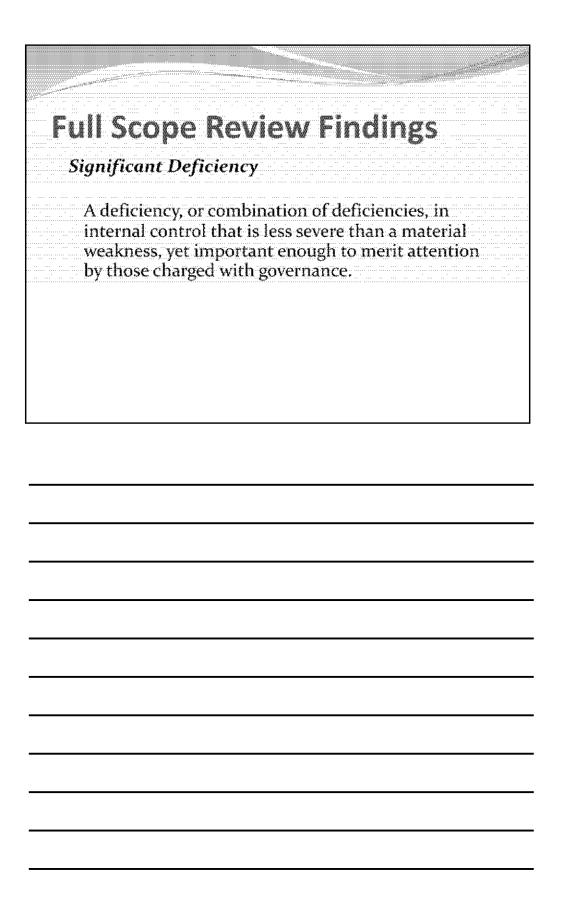
- Draft Report to FTA 30 days after exit conference
- Grantee Response 30 days after receipt of draft
- Final Report 21 days after receipt of Grantee response

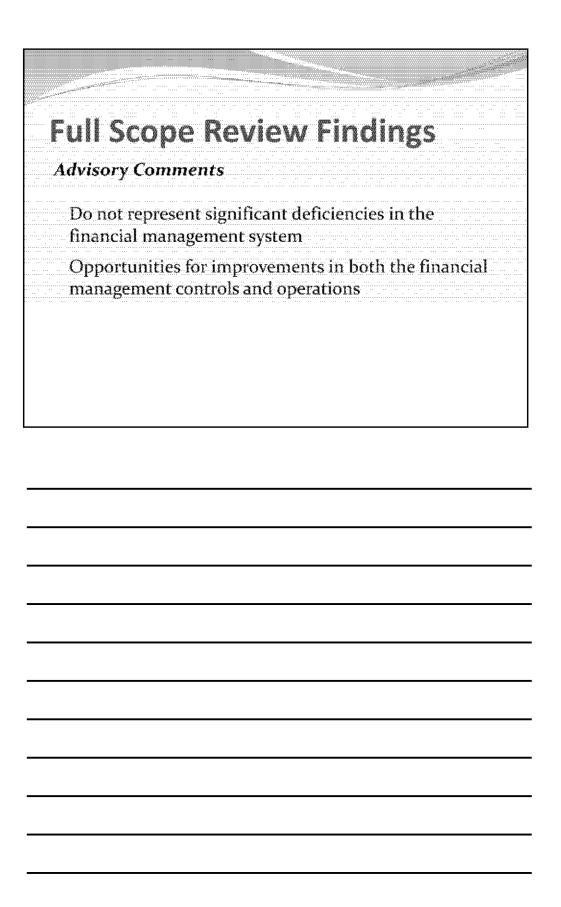
#### Structure of The Full Scope Review Report

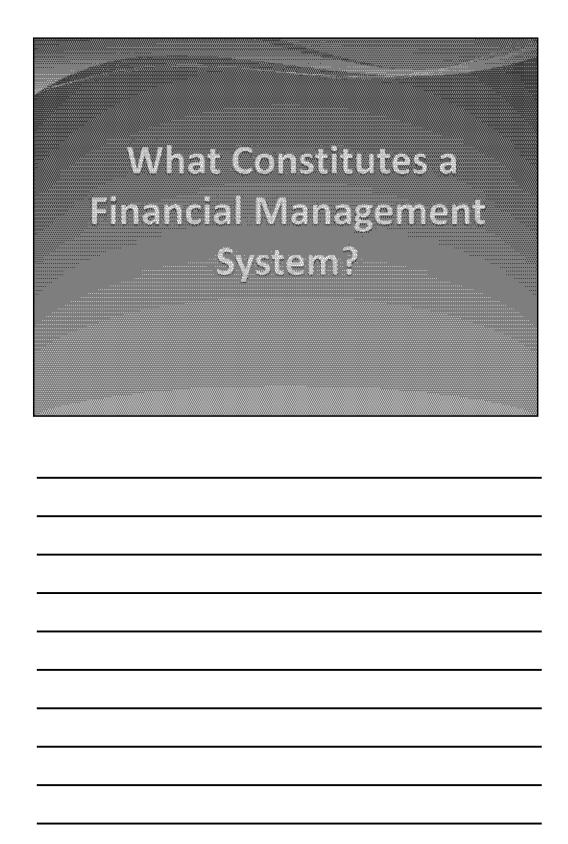
- Accountants' Report
- Section I Description of Grantee
- Section II Material Weakness Conditions
- Section III Significant Deficiency Conditions
- Section IV Advisory Comments
- Section V Summary of Findings
- Section VI Common Rule Criteria
- Section VII Grantee Response

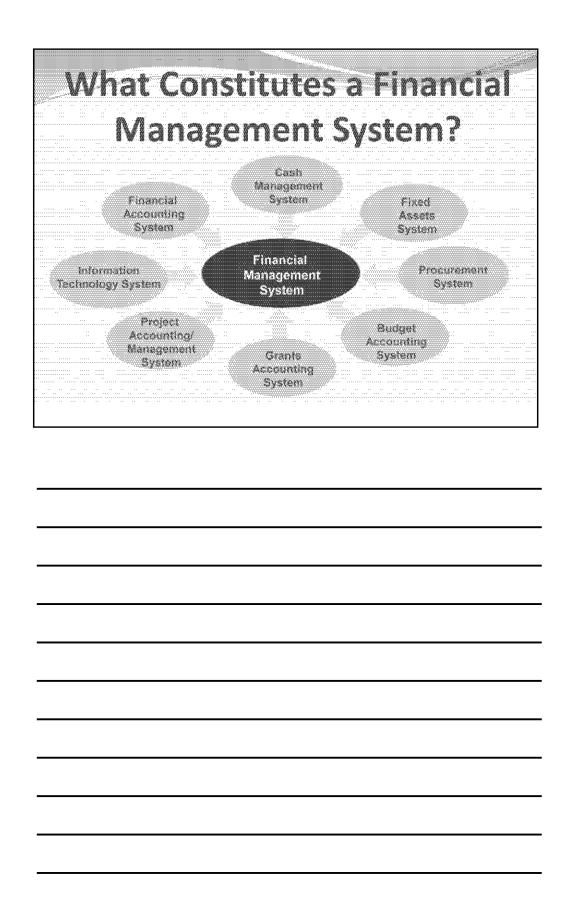
A sample report can be found at the end of this section.

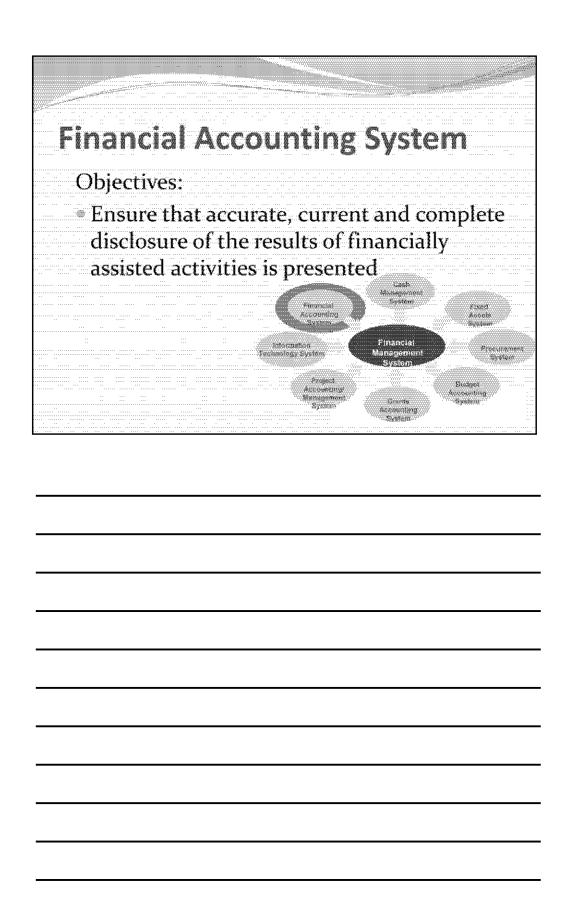




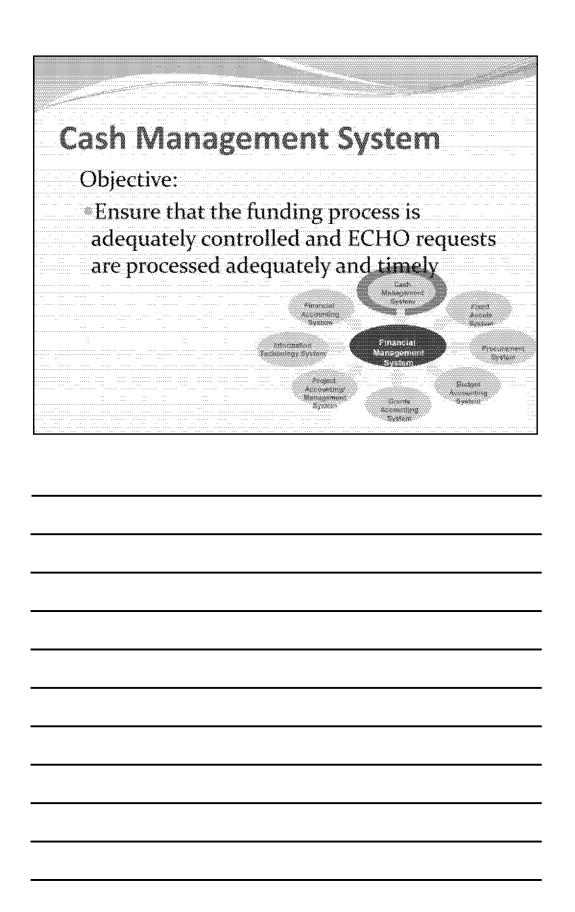


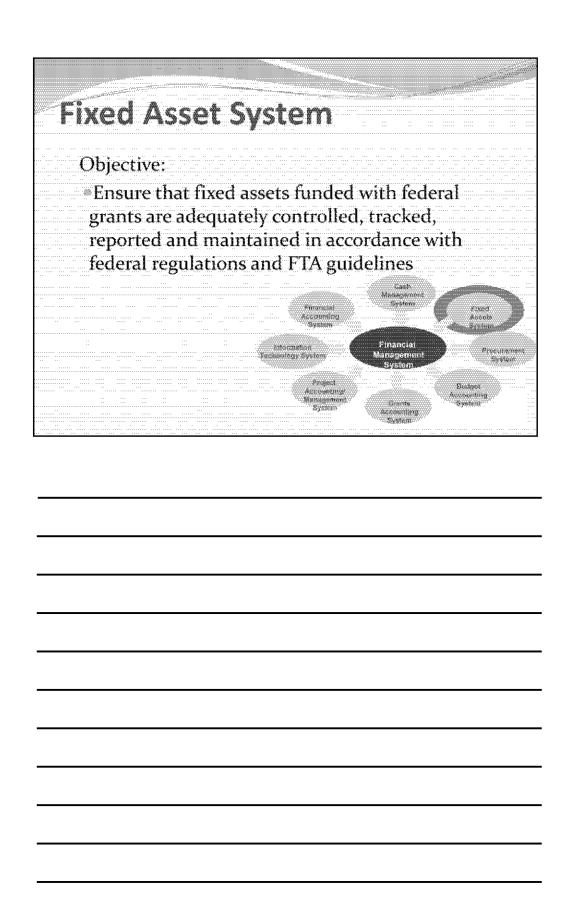


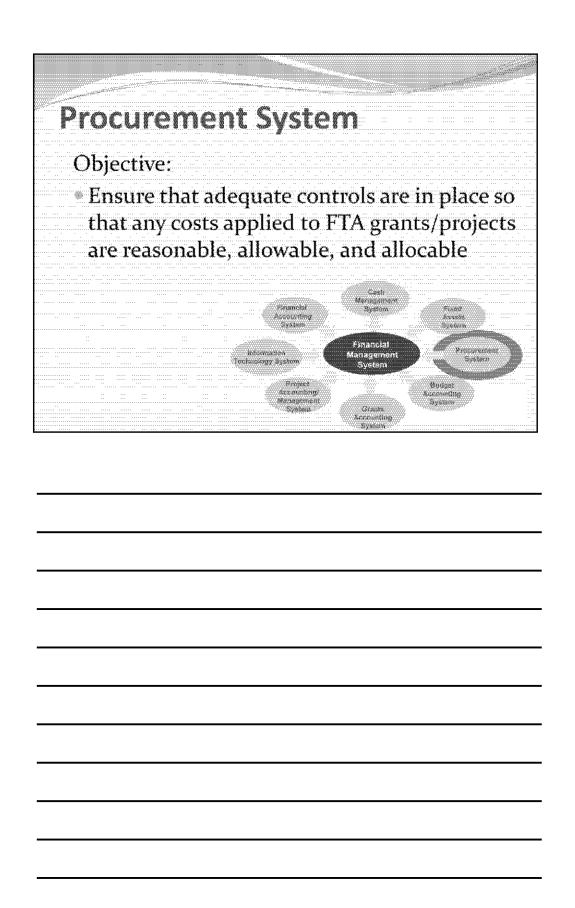


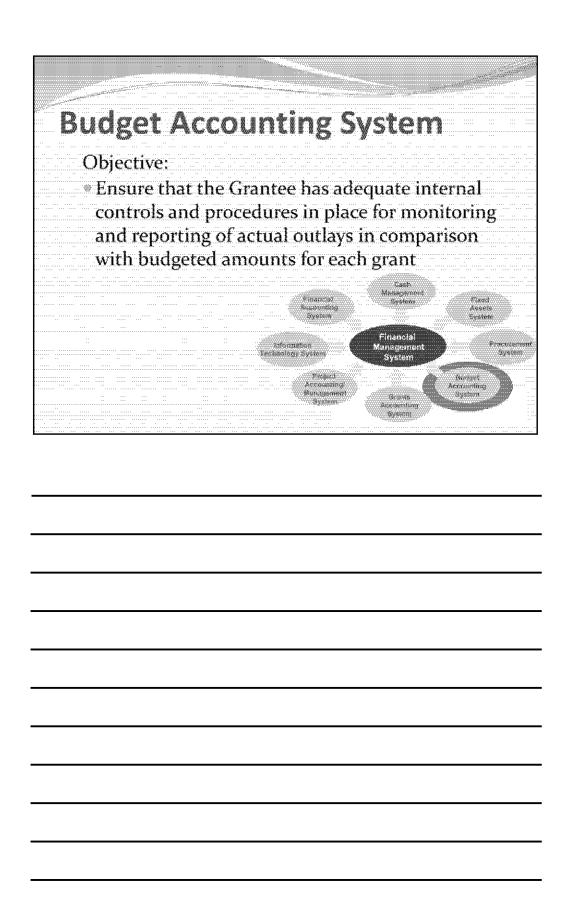


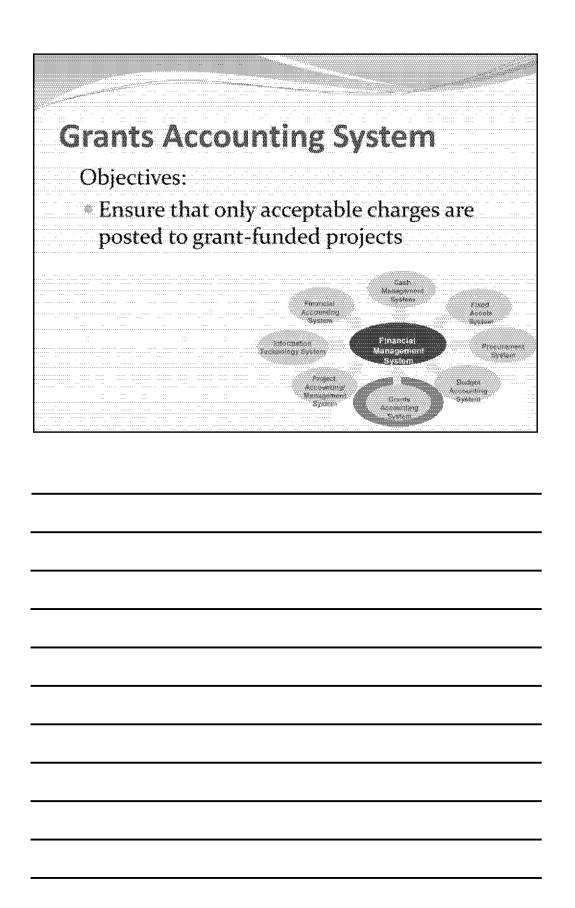
## **Financial Accounting System** Objectives: \* Ensure that financial transactions are supported by appropriate source documentation Ensure that the general accounting management process is adequately controlled and the financial position of the grantee is properly reported to interested parties











# **Grants Accounting System** Objectives: Ensure that controls are adequate to generate accurate grant records and budgets Ensure that authorized grant activity is posted to records in a timely, accurate and complete manner

# **Project Management System** Objectives: Ensure that the grants management system properly reflects the status of projects through interface with the financial management system Ensure that project changes can be identified and addressed in a timely 2,17,220t,17,25 manner Financial

# Information Technology System Objectives: • Ensure that the needs of the grantee's system are adequately supported To plan and prepare for the protection of grantee assets and records from damage, loss or unauthorized use 9,199206,1978 4 Financial

#### FINANCIAL MANAGEMENT OVERSIGHT REVIEW

Full Scope Systems Review

of the

Sample Regional Transit Authority

\_\_\_\_

#### PERFORMED FOR

## U.S. DEPARTMENT OF TRANSPORTATION FEDERAL TRANSIT ADMINISTRATION

#### Prepared by

Independent Accountant LLC

Report Date: November 21, 20XX

Draft Report Submission Date: June 22, 20XY

Final Report Submission Date: July 22, 20XY

CONTRACT NUMBER: DTFT-XX-01-D-XXXXX

TASK ORDER NUMBER: X

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#### **Independent Accountants Report**

To the Regional Administrator Federal Transit Administration Region \_\_:

We understand that the Federal Transit Administration (FTA) has awarded Sample Regional Transit Agency (Sample) the grants listed in Section I of this report. We have examined management's assertion, included in its representation letter dated xxx, that Sample maintained effective internal control over its compliance with FTA financial management system requirements as of xxx, as set forth in Section VI of this report, based on 49 CFR part 18 "Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments" (Common Rule), Section 18.20, "Standards for Financial Management Systems." Management is responsible for maintaining effective internal control over Sample's compliance with FTA financial management system requirements. Our responsibility is to express an opinion on management's assertion based on our examination.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included obtaining an understanding of the financial management system, testing, and evaluating the design and operating effectiveness of the financial management system, and performing such other procedures, as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion. Our examination does not provide a legal determination on Sample's compliance with FTA financial management system requirements.

Because of inherent limitations in any internal control structure or financial management system, misstatements due to error or fraud may occur and not be detected. Also, projections of any evaluation of the financial management system to future periods are subject to the risk that the financial management system may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assertion that Sample maintained effective internal control over its compliance with FTA financial management system requirements as of (date), is fairly stated, in all material respects, based on the criteria established by the FTA as set forth in Section VI of the report.

Independent Accountant, LLC

November 21, 20XX

#### SECTION I

## Brief Description of the Sample Regional Transit Authority (as prepared by Grantee)

The Sample Regional Transit Authority (SAMPLE TRANSIT AGENCY) is an independent transit authority established under the laws of the State of South Transylvania serving Sample metropolitan area, including the City of Sample, Sample County, and North Sample. SAMPLE TRANSIT AGENCY took over the operations of the transit service in the City of Sample in 19WW. SAMPLE TRANSIT AGENCY is governed by a board consisting of 18 directors appointed by authority member cities including the cities of Sample and North Sample, town of Mount Vesuvius, as well as Harlem, Gulliver's island, and Kalico Island. The number of directors from each government is proportionate to its population within the authority's service area, with an additional three members appointed by the Sample County Legislative Delegation, a body of eight (8) state senators and twelve (12) representatives, who represent Sample County. The population of SAMPLE TRANSIT AGENCY's service area is approximately 500,000.

SAMPLE TRANSIT AGENCY outsources both its fixed route and paratransit operations. The fixed route contractor is Transit Operations Corporation (TOC) and the paratransit operator is Conehead. SAMPLE TRANSIT AGENCY currently operates a network of 37 fixed routes. Service is provided weekdays from approximately 6:00 a.m. to 12:00 a.m. Saturday service is operated from 7:00 a.m. to 11:45 p.m. Sunday service is operated from 8:30 a.m. to 11:45 p.m. The paratransit service, known as Tel-U-Ride, operates during the same days and hours of service as the fixed routes.

The following information represents a list of SAMPLE TRANSIT AGENCY's open FTA grants as of November 21, 20XX:

Grant No.	Amount	<u>Year</u>	<u>Description</u>
ST-9X-XXXX ST-XV-XXXX ST-XV-XXXI ST-9X-XXX2 ST-9X-XXX3	\$4,680,803 \$2,550,931 \$720,000 \$2,582,224 \$3,770,033	20XT 20XS 20XX 20XW 20XW	Sample Intermodal Terminal Sample Intermodal Terminal Statewide Bus Earmark Urbanized Area Formula Urbanized Area Formula
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#### SECTION II

#### Material Weaknesses

For purposes of this examination, a material weakness is a significant deficiency, or combination of significant deficiencies, in the design or operation of one or more components of the financial management system that results in more than a remote likelihood that a material misstatement will not be prevented or detected by management or employees in the normal course of performing their assigned functions.

The conditions and recommendations are provided below, with notation of the standard impacted, discussion of the significance of the condition, a summary of the Grantee's proposed corrective actions and evaluation thereof.

<u>II.1</u>	
Condition	
<u>Criteria</u>	
<u>Cause</u>	
<u>Effect</u>	
Corrective Action	
Recommendation	
Grantee Response	

#### **SECTION III**

#### Significant Deficiencies

A significant deficiency is a control deficiency, or combination of control deficiencies, in the design or operation of one or more components of the financial management system which could adversely affect SAMPLE TRANSIT AGENCY's ability to initiate, authorize, record, process, or report financial and related data reliably consistent with the requirements of 49 CFR 18.20, as set forth in Section VI such that there is a more than remote likelihood that a misstatement that is more than inconsequential will not be prevented or detected by management or employees in the normal course of performing their assigned functions. These are not considered to be material weaknesses in the financial management system, as previously defined.

These conditions and recommendations are provided below, with notation of the standard impacted, discussion of the significance of the condition, a summary of the Grantee's proposed corrective actions and evaluations thereof.

<u>III.1</u>		
Condition		
<u>Criteria</u>		
<u>Cause</u>		
<u>Effect</u>		
Corrective Action		
Recommendation		
Grantee Response		

#### **SECTION IV**

#### **Advisory Comments**

For purposes of this review, an advisory comment represents a minor control deficiency in the design or operation of the financial management system that is not significant enough to adversely affect SAMPLE TRANSIT AGENCY's ability to record, process, summarize, and report financial and related data consistent with the requirements of 49 CFR 18.20.

The advisory comments presented in this section represent matters that came to our attention during the course of the review, and are offered to SAMPLE TRANSIT AGENCY's management as an opportunity for improvement. The advisory comments are provided along with recommendations and discussion of the significance of the comments.

<u>IV.1</u>	
Condition	
<u>Criteria</u>	
<u>Cause</u>	
<u>Effect</u>	
Corrective Action	
Recommendation	
Grantee Response	

### SECTION V Summary of Findings

				Corrective
				Action
Finding		Standards		Implementation
Reference	Finding	Impacted	Recommendation	Date

#### **SECTION VI**

## Criteria Established By The FTA For Grantees' Financial Management Systems

The following criteria have been set forth by the Federal Transit Administration (FTA) as standards for the financial management systems of FTA Grantees. Unless otherwise noted, these criteria are drawn from 49 CFR 18. "Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments" (Common Rule), Section 18.20, "Standards for Financial Management Systems." Additional guidance for applying many of these criteria is provided in various circulars issued by the FTA, U.S. Department of Treasury, and the Office of Management of Budget (OMB).

18.20(b)(1), Financial Reporting. Grantees must have procedures to provide reasonable assurance that "accurate, current, and complete disclosure of the financial results of financially assisted activities [are] made in accordance with the financial reporting requirements of the grant or subgrant."

18.20(b)(2), Accounting Records. "Grantees and sub Grantees must maintain records which adequately identify the source and application of funds provided for financially-assisted activities. These records must contain information pertaining to grant or subgrant awards and authorizations, obligations, unobligated balances, assets, liabilities, outlays or expenditures, and income." The Grantee's project financial accounting system must interface with the Grantee's overall financial management system.

18.20(b)(3), *Internal Control*. "Effective control and accountability must be maintained for all grant and subgrant cash, real and personal property, and other assets." Specifically with respect to fixed asset records, 49 CFR 18.32(d), requires that Grantees and sub Grantees must maintain a fixed asset control system providing detailed property records for assets acquired under a grant or subgrant, and including procedures to provide reasonable assurance that safeguards are present to prevent or detect unauthorized acquisition, use, or disposition of the property, and that maintenance procedures are implemented for such assets.

18.20(b)(4), *Budget Control*. "Actual expenditures or outlays must be compared with budgeted amount for each grant or subgrant. Financial information must be related to performance or productivity data, including the development of unit cost information whenever appropriate or specifically required in the grant or subgrant agreement."

#### **SECTION VI**

## Criteria Established By The FTA For Grantees' Financial Management Systems (cont.)

18.20(b)(5), Allowable Costs. Grantees must have procedures to provide reasonable assurance that "Office of Management and Budget (OMB) Circular A-87 cost principles are incorporated within 49 CFR 18.22, agency program regulation, and the terms of grant and subgrant agreements will be followed in determining the reasonableness, allowability, and allocability of costs." If indirect costs are being charged to the grant, Grantees must prepare a cost allocation plan that is approved by its cognizant agency.

18.20(b)(6), Source Documentation."Accounting records must be supported by such source documentation as canceled checks, paid bills, payrolls, time and attendance records, contract and subgrant award documents, etc."

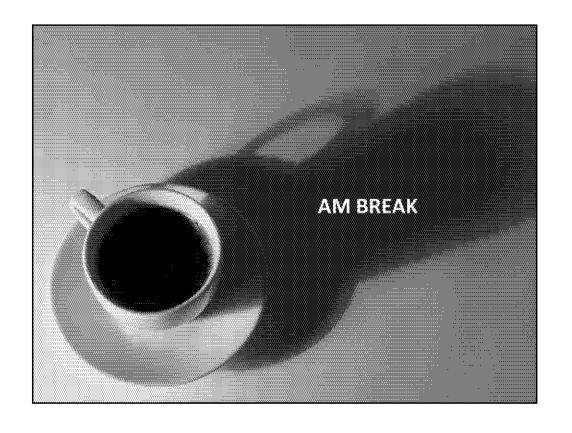
18.20(b)(7), Cash Management. "Procedures for minimizing the time elapsing between the transfer of funds from the U.S. Treasury and disbursement by Grantees must be followed whenever advance payment procedures are used. Grantees must establish reasonable procedures to ensure the receipt of reports on Subgrantee's cash balances and cash disbursements in sufficient time to enable them to prepare complete and accurate cash transactions reports to the awarding agency. When advances are made by letter-of -credit or electronic transfer of funds methods, the Grantee must make draw downs as close as possible to the time of making disbursements. Grantees must monitor cash draw downs by their sub Grantees to assure that they conform substantially to the same standards of timing and amount as apply to advances to the Grantees."

18.30, *Project Change Accounting*. The Grantee's project financial accounting system must be able to document and track project changes that result in the need for additional funds, a revision in the scope or objectives of the project, or a need to extend the period of availability of funds or any other changes or budgetary transfers which would require the prior written approval of the FTA.

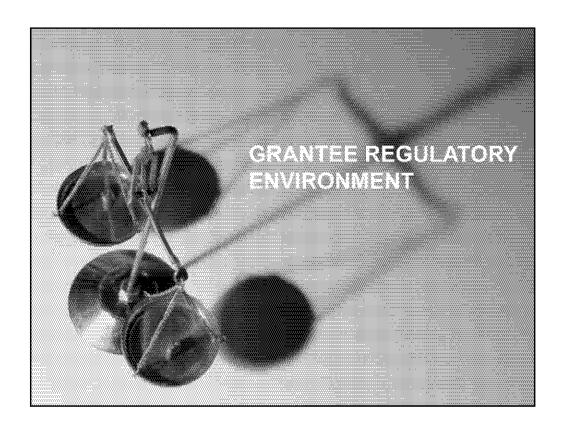
#### Section VII

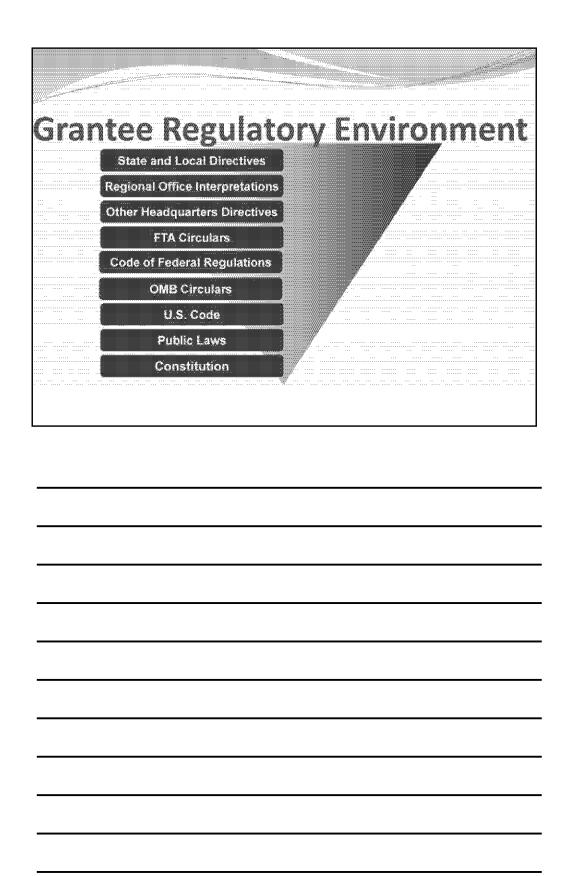
#### Grantee's Response to Findings and Advisory Comments (Full Text)

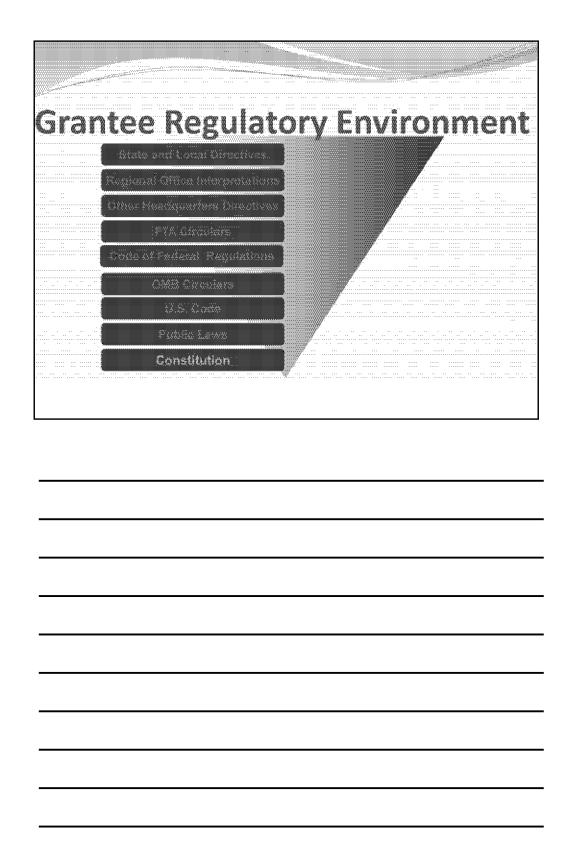
FTA's Region IV office furnished a draft of this report to SAMPLE TRANSIT AGENCY on February 16, 20XY with a request for them to respond to the conditions and comments. The Grantee's response was received on May 31, 20XY. Summaries of their response are included with the related conditions and comments in previous sections of this report. The full text of the response is provided on the following pages.

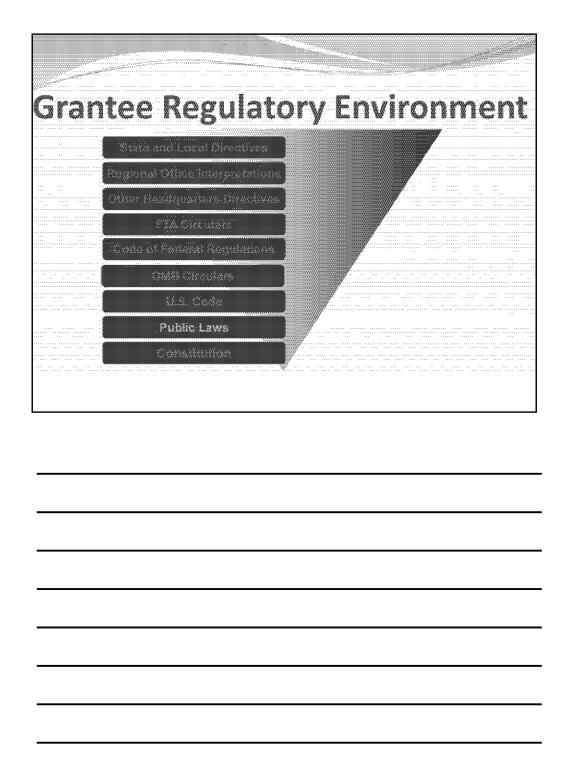


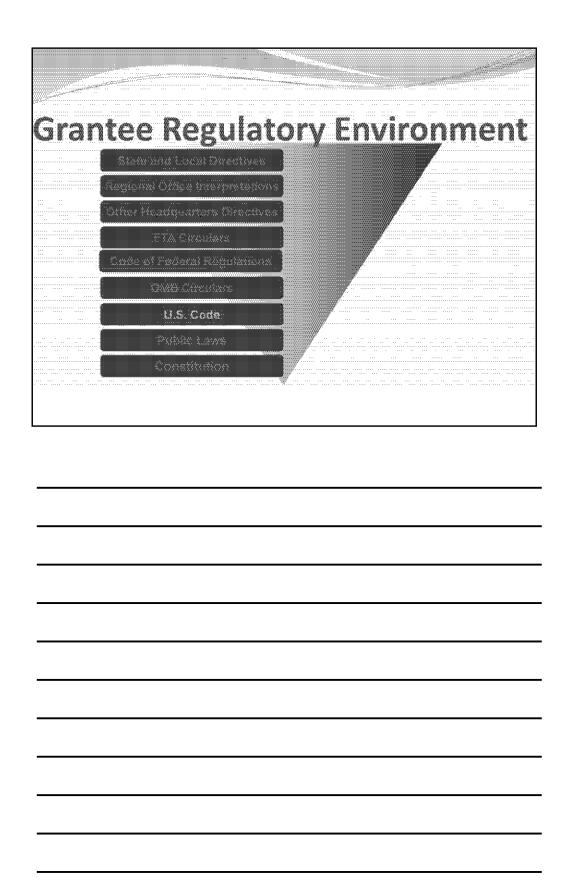
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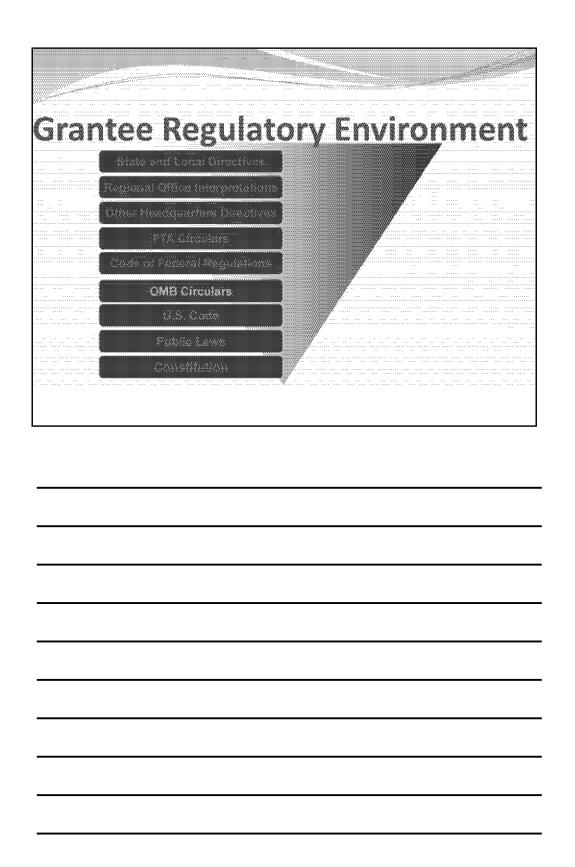










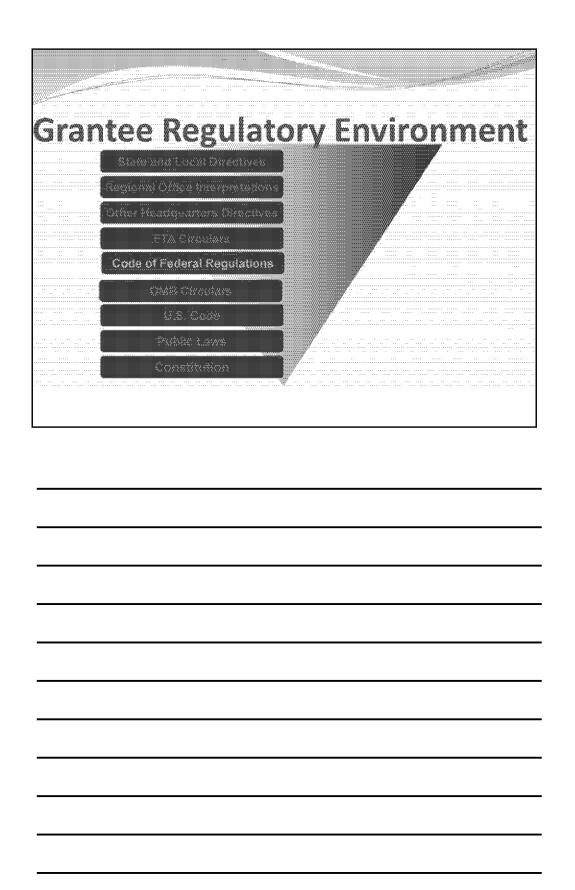


# Office of Management and Budget (OMB)

- OMB Circulars are established to convey uniform guidance in the form of instructions and information to executive departments and establishments. The Executive Office of the President uses them to exercise managerial and policy direction over federal agencies.
- Even though it is mandatory for the federal agencies to follow the Circulars, certain requirements can be waived at the discretion of the OMB.

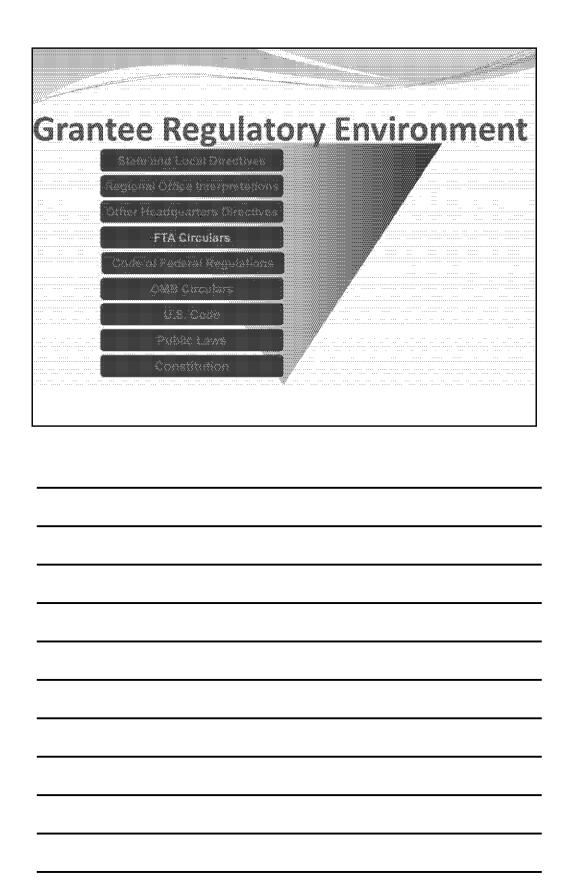
## OMB Circulars Applicable to Grants Management

- A-21 Cost Principles for Educational Institutions
- A-87 Cost Principles for State, Local, and Indian Tribal Governments
- A-122 Cost Principles for Non-Profit Organizations
- A-133 Audits of States, Local Governments, and Non-Profit Organizations



# **Code of Federal Regulations** The Code of Federal Regulations consists of rules made by federal agencies and executive departments of the federal government.

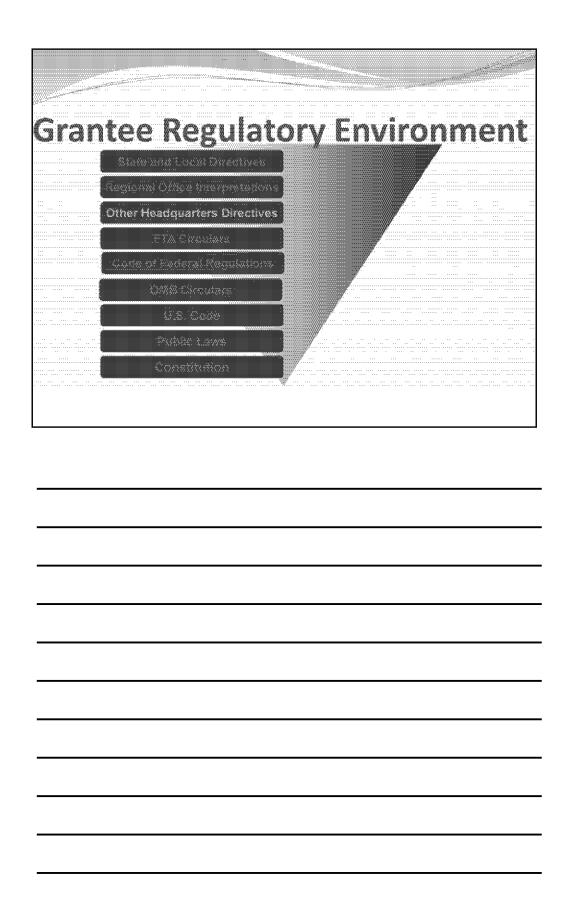
## CFR Title 49 - Transportation 1. Organizing and delegation of power and duties 3. Official seal 18. Uniform administrative requirements for grants and cooperative agreements to State and local governments 19. Uniform administrative requirements for grant and agreements with institutions of higher education, hospitals, and other non-profit organizations 24. Uniform relocation assistance and real property acquisition for Federal and federally assisted programs



FTA Circulars
FTA Circulars are issued in order to outline specific requirements and/or give grantees guidance on how to carry out the Common Rule, federal statutes,  Executive Orders and other FTA policies

# FTA Circulars Grants Management # 4200 - PROCUREMENT C 4220.1F Third Party Contracting Requirements 5000 – GRANTS MANAGEMENT – GENERAL C 5010.1D Grant Management Guidelines · C 5200:1A Full-Funding Grant Agreements Guidance · C 5620.1 Guidelines for Preparing Environmental Assessments

# FTA Circulars Grants Management - cont'd 9000 - CAPITAL FACILITIES AND FORMULA GRANT PROGRAMS C 9030.1C Urbanized Area Formula Program: Grant Application Instructions C 9040 IF Nonurbanized Area Formula Program Guidance and Grant Application Instructions C 9070.1F The Elderly and Persons With Disabilities Program Guidance and Application Instructions C 9300.1B Capital Program: Grant Application Instructions - C 9400.2A Federal Transit Administration Design and Art in Transit Projects C 9500.1 Intergovernmental Review of FTA Planning, Capital and Operating Programs and Activities

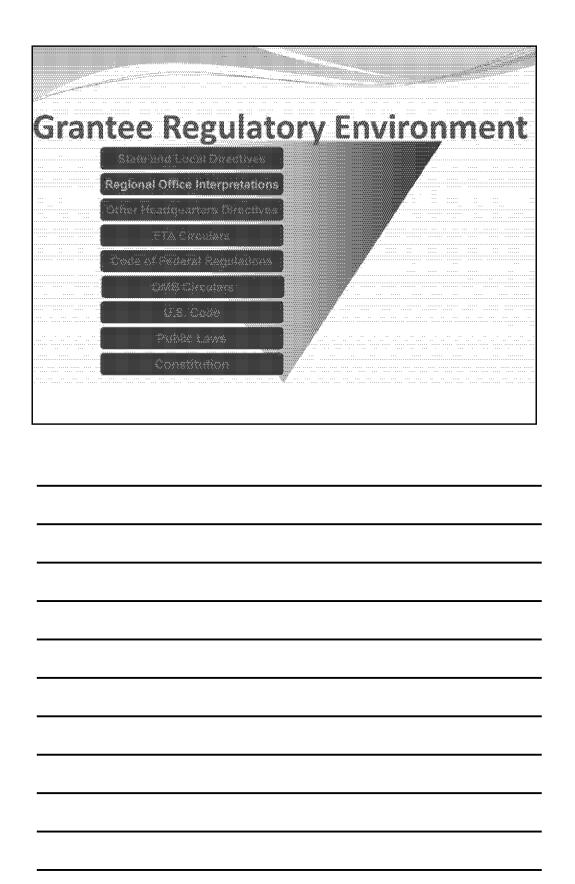


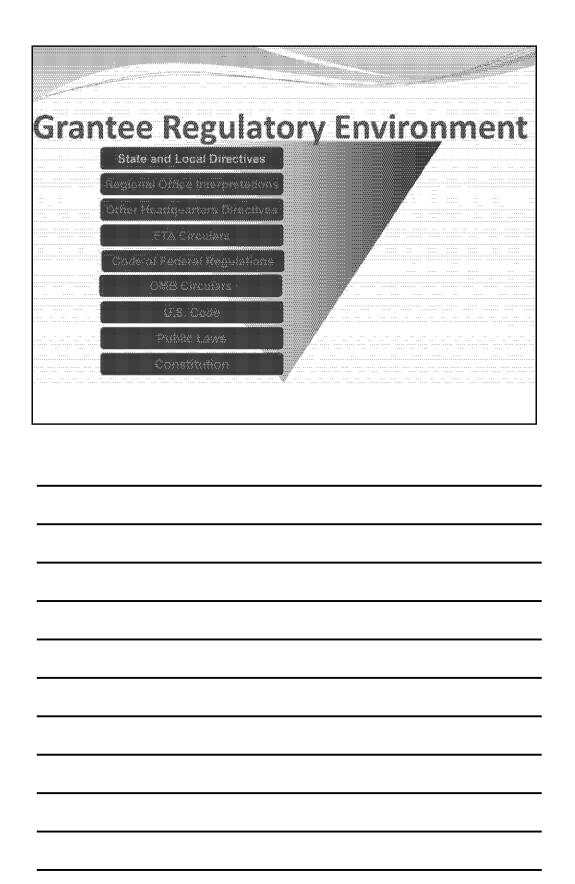
## Other Headquarters Directives

In addition to the Code of Federal Regulations, Federal Register notices, Circulars and Dear Colleague letters, the FTA communicates its policies and procedures to grantees via the following means:

- FTA Agreements, such as The FTA Master Agreement, Grant
   Agreements, Supplemental Agreements, Cooperative Agreements,

   Federal Transit Program Fiscal Year Requirements
- The FTA website, www.dot.fta.gov, which serves as a resource for all the items communicated above
- The FTA also updates their website with any new information and documents that they publish





State and Local Directives	
In many instances Federal policy	
incorporates, by reference, state and local policy.	



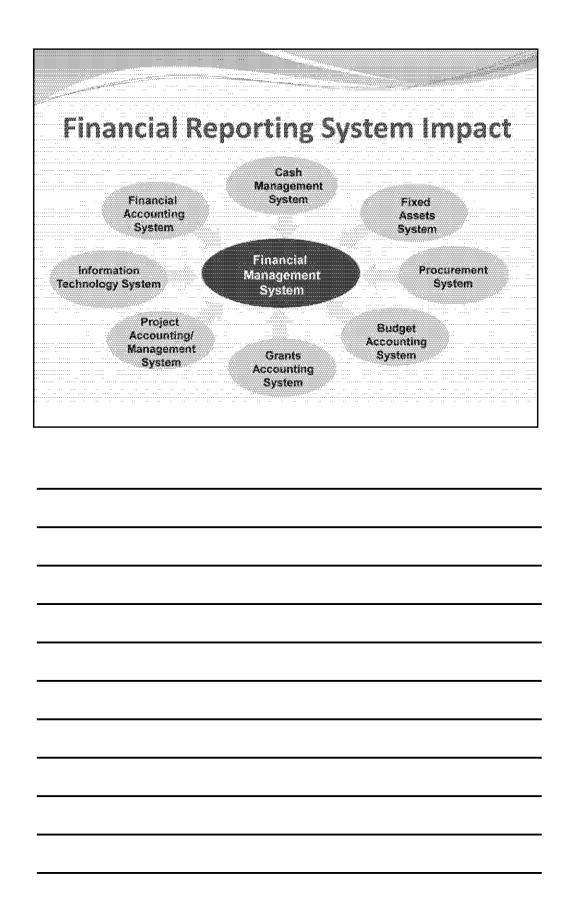
### Common Rule – "Standards For Financial Management Systems"

- Not a choice or option
- Required for all grant recipients and sub-recipients
- Standards cannot be waived by FTA

·			-

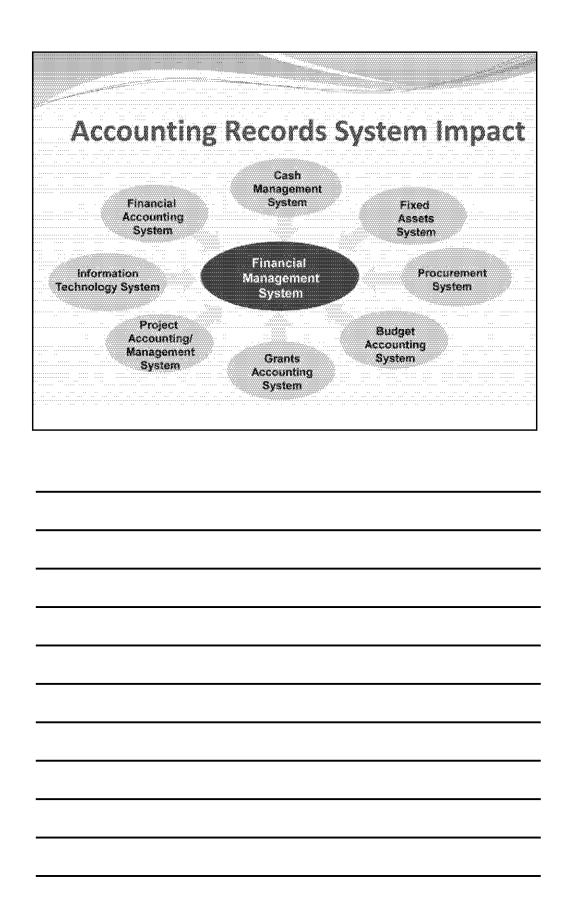
#### Standards Addressed By Common Rule 49 CFR 18.20 Financial Reporting Allowable Cost Accounting Records Source Documentation Internal Control Cash Management Budget Control Project Changes \*\* \*\*Special FTA Requirement, 49 CFR 18.30

## **Financial Reporting** 18.20(b)(1) Financial Reporting. Grantees must have procedures to provide reasonable assurance that "accurate, current, and complete disclosure of the financial results of financially assisted activities (are) made in accordance with the financial reporting requirements of the grant or subgrant."



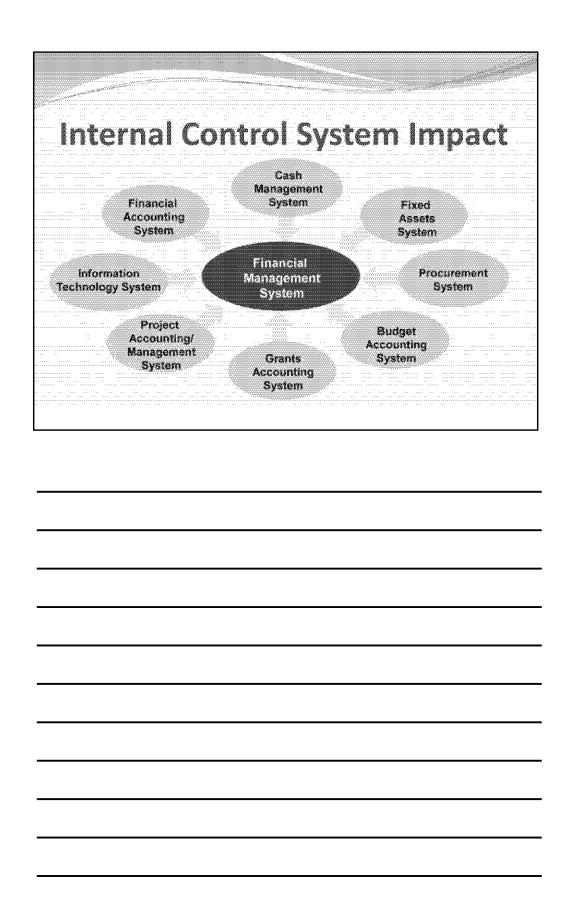
# **Financial Reporting Common Conditions** Reported amounts of federal expenditures not in agreement with general ledger. Incorrect reporting of encumbrances.

#### **Accounting Records** 18.20(b)(2) Accounting Records. "Grantees and subgrantees must maintain records, which adequately identify the source and application of funds provided for financially-assisted activities. These records must contain information pertaining to grant or subgrant awards and authorizations, obligations, unobligated balances, assets, liabilities, outlays or expenditures, and income". The grantee's project financial accounting system must interface with the grantee's overall financial management system.



## **Accounting Records** Common Conditions: Grantee does not have a formal record retention policy. Accounting system not being used and grant expenditures tracked using an Excel spreadsheet.

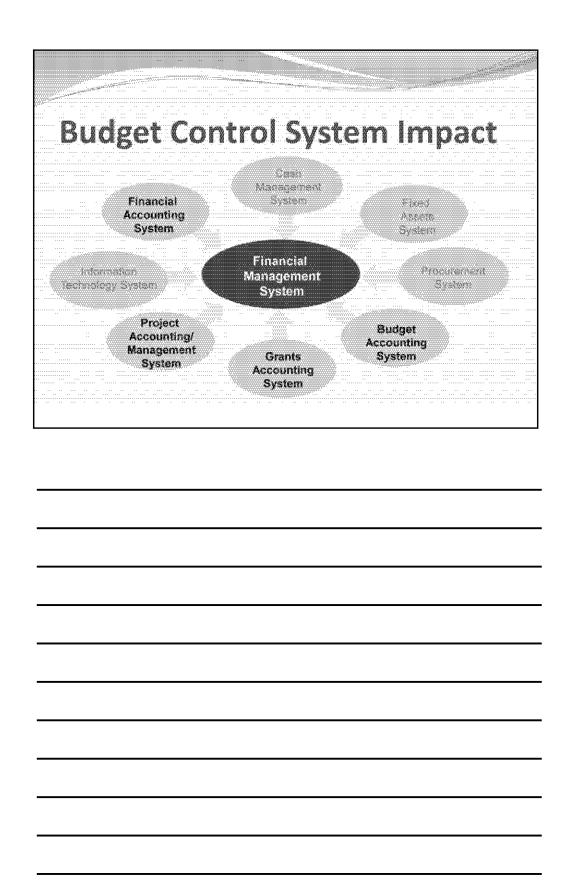
#### **Internal Controls** 18.20(b)(3) Internal Control. "Effective control and accountability must be maintained for all grant and subgrant cash, real and personal property, and other assets." Specifically with respect to fixed asset records, 49 CFR 18.32(d) requires that grantees and subgrantees maintain a fixed asset control system providing detailed property records for assets acquired under a grant or subgrant, and include procedures to provide reasonable assurance that safeguards are present to prevent or detect unauthorized acquisition, use, or disposition of the property, and that maintenance procedures are implemented for such assets.



# **Internal Control** Broad term for accountability, segregation of duties, and checks and balances Separate assets from the record keeper.

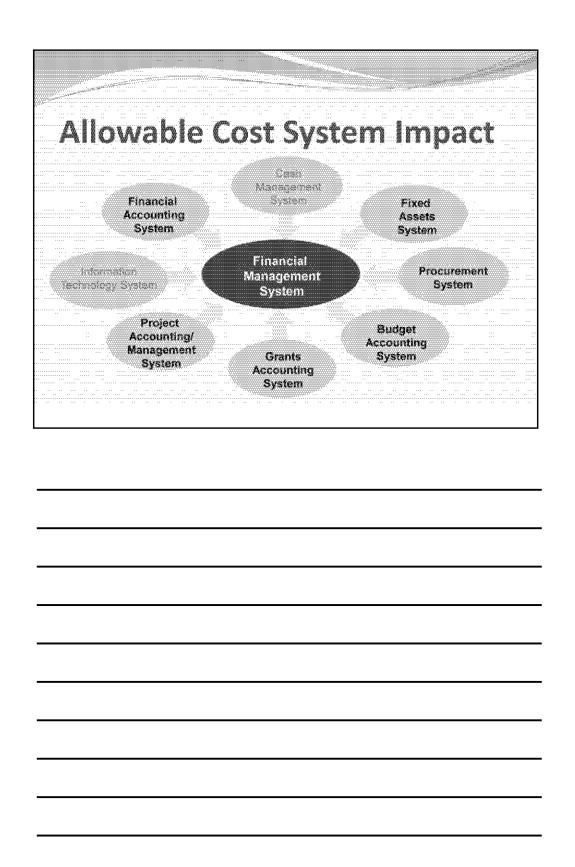
## **Internal Control Common Conditions:** The grantee lacks a comprehensive disaster recovery plan Same individual maintains general ledger, reconciles cash accounts, receives cash, and maintains accounts receivable ledger

## **Budget Control** 18.20(b)(4) Budget Control. "Actual expenditures or outlays must be compared with budgeted amounts for each grant or subgrant. Financial information must be related to performance or productivity data, including the development of unit cost information whenever appropriate or specifically required in the grant or subgrant agreement."



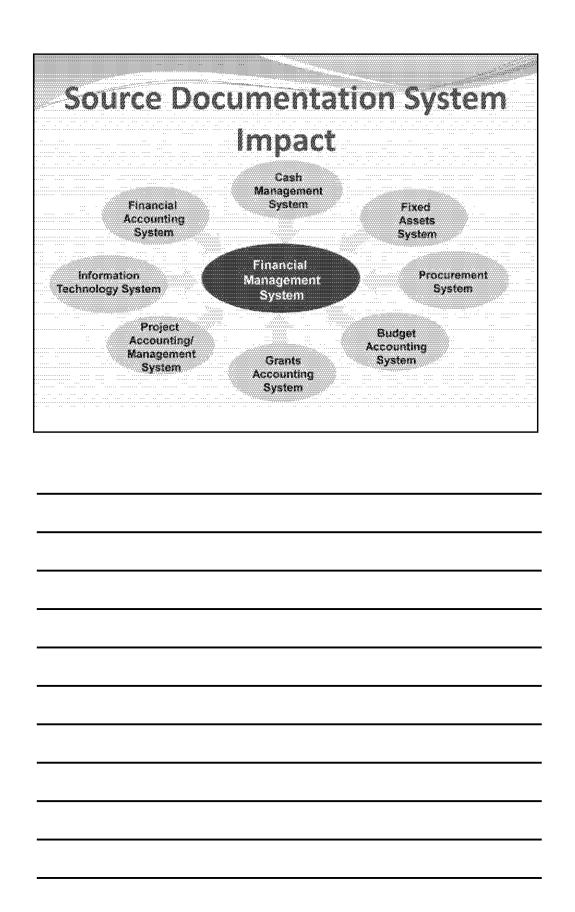
# **Budget Control** Common Conditions: Budget to actual analysis not performed for capital budget Explanations for budget variances not documented

### Allowable Cost 18.20(b)(5) Allowable Cost. Grantees must have procedures to provide reasonable assurance that OMB cost principles, Circular A-87( incorporated within 49 CFR 18.22), agency program regulations, and the terms of grant and subgrant agreements will be followed in determining the reasonableness, allowability, and allocability of costs." If indirect costs are being charged to the grant, Grantees must prepare a cost allocation plan that is approved by its cognizant agency.



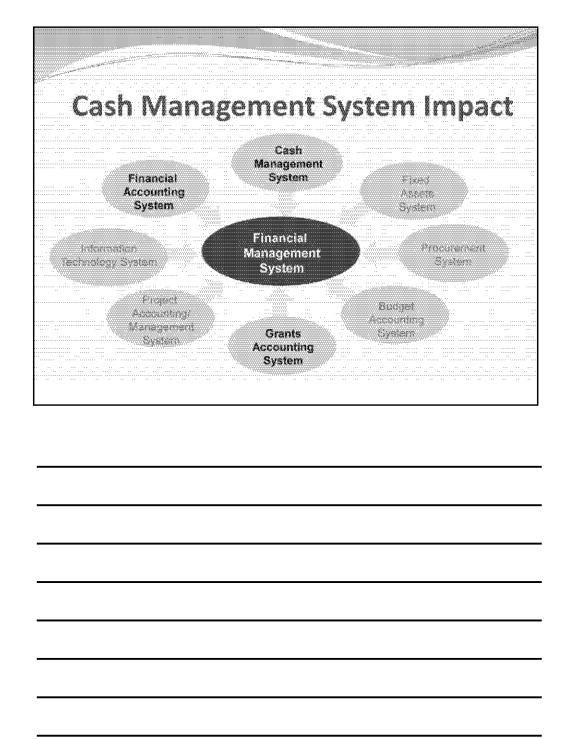
## Allowable Cost Common Conditions: Force Account Plan and Fringe Benefit Rate not documented or approved. Grantee reported amounts of federal funding in excess of eligible expenditures.

## **Source Documentation** 18.20(b)(6) Source Documentation. "Accounting records must be supported by such source documentation as canceled checks, paid bills, payrolls, time and attendance records, contract and subgrant award documents, etc."



## Source Documentation Common Conditions: \* Justification for sole source procurement was not documented. Monthly reconciliations of accounts receivable and accounts payable prepared, but documentation is not retained.

#### **Cash Management** 18.20(b)(7) Cash Management. "Procedures for minimizing the time elapsing between the transfer of funds from the U.S. Treasury and disbursement by grantees must be followed whenever advance payment procedures are used. Grantees must establish reasonable procedures to ensure the receipt of reports on subgrantee's cash balances and cash disbursements in sufficient time to enable them to prepare complete and accurate cash transactions reports to the awarding agency. When advances are made by letter-of-credit or electronic transfer of funds methods, the grantee must make draw downs as close as possible to the time of making disbursements. Grantees must monitor cash draw downs by their subgrantees to assure that they conform substantially to the same standards of timing and amount as apply to advances to the grantees."



#### **Excessive Cash Rules**

- Cash received from FTA must be disbursed within three business days
- If not disbursed within three days, cash becomes excess funds and must be returned to FTA

#### **Exceptions:**

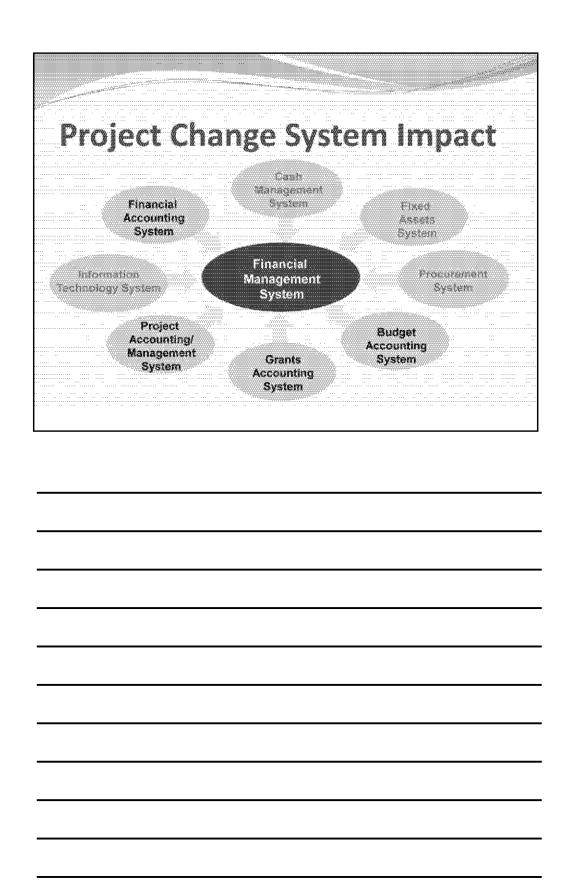
- If drawing early by mistake and funds will be disbursed within 7 calendar days; or
- If <\$10,000 will be disbursed within 30 calendar days then funds may be retained, but interest accrues beginning with day four

## **Cash Management** Common Conditions: \* Grantee drew down federal funds in excess of need and did not remit overdraw to FTA. Preventive Maintenance funds draw down 1/12 per month rather than as expenses incurred.

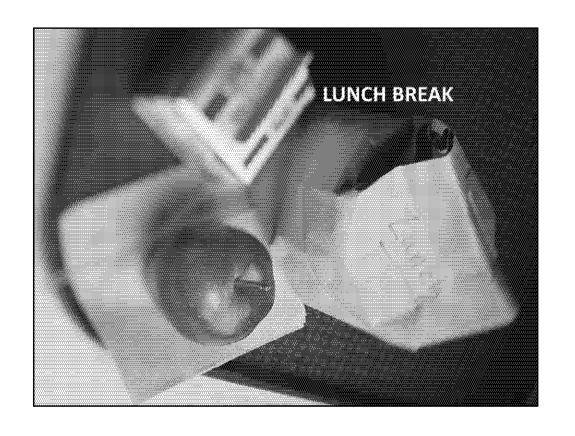
# Other Cash Management Topics Farebox Collection Procedures Controls Over ECHO Drawdown Process Controls Over Cash in Banks

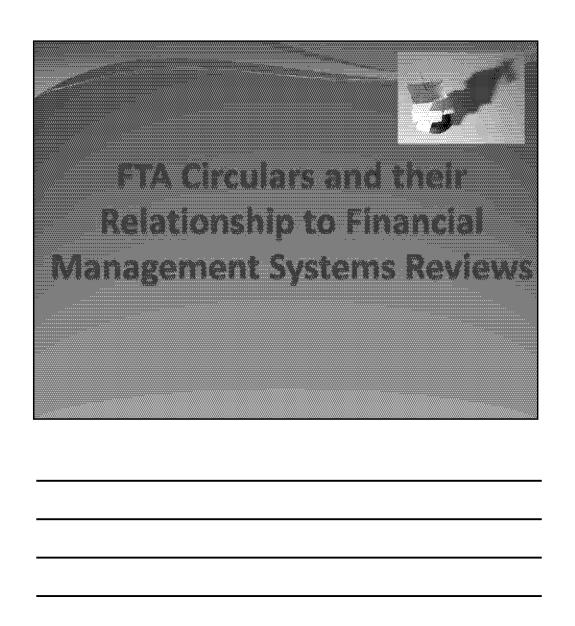
## **Other Cash Management Conditions Common Conditions:** No reconciliation of ECHO drawdowns to bank records and TEAM ECHO passwords shared by more than two individuals Bank reconciliations not performed in a timely manner No reconciliation of farebox cash collected to GFI records

	Prifyri Primes
Project Change	
18.30 Changes. "Unless waived by the awarding agency, certain types of post-award changes in budgets and projects shall require the prior written approval of the awarding	
agency."	
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## **Project Change** Common Conditions: Change orders on federally funded projects are not reviewed for federal funding eligibility Required FTA approval is not being obtained for project scope changes.





### FTA Circulars and Their Relationship to Full Scope Reviews

As previously noted, FTA circulars are issued to establish FTA policy and implement the requirements of the common rule. The two circulars that have the biggest impact on the Financial Management Systems (FMS) Reviews are circulars 5010.1D\* and 4220.1F\*.

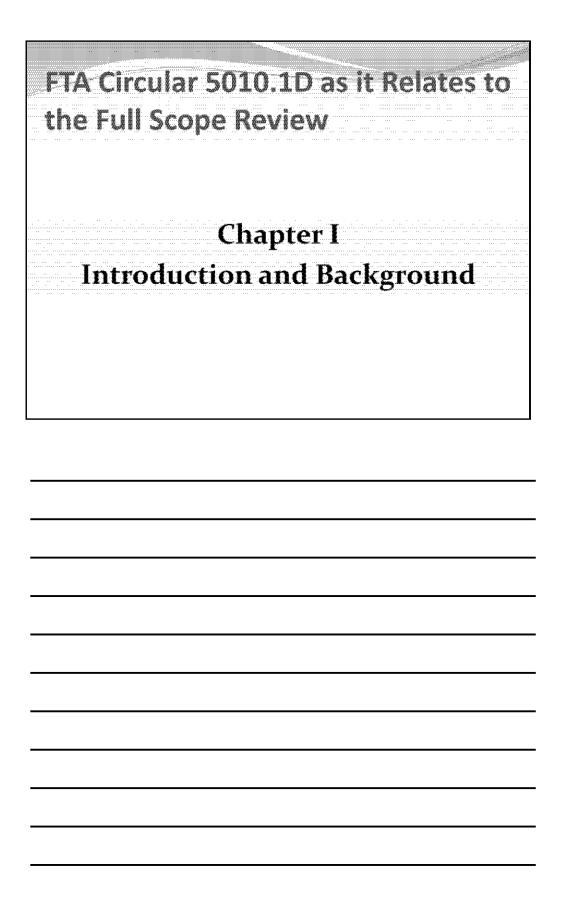
\*New circulars issued in November 2008.

## Circular 5010.1D General Changes Effective date: November 1, 2008 Reorganization of Chapters Grant Management and Project Management addressed separately Updated to reflect current policy and practice Links for additional sources of information Examples added

#### Chapter Reorganization

Chapter	Circular 5010.1C	Circular 5010.1D
Chapter I	Project Administration and Management	Introduction and Background
Chapter II	Management of Real Property, Equipment & Supplies	Circular Overview
Chapter III	Financial Management	Grant Administration
Chapter IV	Payment Procedures	Project Management
Chapter V		Oversight
Chapter VI		Financial Management

#### FTA Circular 5010.1D as it Relates to the Full Scope Review Appendices **Table of FTA Circulars** \* Appendix A: Appendix B: Real Estate Acquisition Management Plan Guide for Appraisal Scope of Work Appendix C: Appendix D: Rolling Stock Status Report Cost Allocation Plans \* Appendix E: Request for Advance/Reimbursement Appendix F: \* Appendix G: References \* Appendix H: Contact Information



# FTA Circular 5010.1D as it Relates to the Full Scope Review **Chapter II** Circular Overview

## FTA Circular 5010.1D as it Relates to the Full Scope Review, Chapter II **Chapter Topics** Applicable Program Descriptions Grant Management Responsibilities Civil Rights Requirements

#### FTA Circular 5010.1D Applicable to FTA Grants at 49 U.S.C. Chapter 53, Sections:

- 5303, 5304 & 5305 Metropolitan Planning
- 5307 Urbanized Area Formula Program
- 5308 Clean Fuels Program
- 5309 Capital Program
- 5310 Elderly and Disabled
- 🕝 5311 Nonurbanized Area Formula Program
  - 5313 Transit Cooperative Research Program

#### **Other Applicable Circulars**

9030.1C - Urbanized Area Formula Program (5307)

9040.1F - Non-urbanized Area Formula Grants (5311)

9045.1 - New Freedom (5317)

9050.1 – Job Access and Reverse Commute (5316)

9070.1F - Elderly and Disabled Grants (5310)

9300.1B - Capital Program (5309)

#### Grantee Role

Administration of and management of grant in compliance with grant agreement and applicable FTA circulars and regulations. Includes:

- funds passed through to subrecipient
- submission of annual certification and assurances

#### FTA Role

- Headquarters: Broad, program-level role in administration of programs
- Regional/Metropolitan Offices: Day-today administration of grants, projects, and programs.

# FTA Circular 5010.1D as it Relates to the Full Scope Review **Chapter III Grant Administration**

## FTA-Circular 5010.1D as it Relates to the Full Scope Review, Chapter III **Chapter Topics** Grant Application Process Reporting Requirements Grant Modifications Grant Close Out Suspension and Termination Record Retention and Access

### FTA Circular 5010.1D as it Relates to the Full Scope Review, Chapter III Reporting Requirements - Non-ARRA grants Federal Financial Report (Quarterly)\* Milestone/Progress Reports (Quarterly)\* - Transit Enhancement Reports Civil Rights Reports · Reports of Significant Events National Transit Database Reports \*FSRs and Milestone reports due annually for: Non-urbanized area formula Elderly and persons with disabilities - Metropolitan Planning State Planning Research Programs

#### Reporting Requirements – Non-ARRA grants Exceptions

- Section 5309 Grants: regardless of location or population, reports are required quarterly when grant includes construction of facilities
- State Departments of Transportation:
  - Required to report annually for all state-administered programs
  - Quarterly reports required when 5309 grant includes construction of facilities
- At its discretion, FTA may request other special reports or project management meetings

Reporting Requirements - ARRA grants

#### Section 1512 Reporting

- Quarterly
- Must be submitted no later than 10 days after the end of each calendar quarter
- First reporting deadline was October 10, 2009

Reporting Requirements - ARRA grants

#### Section 1512 Reporting

- Must report on:
  - Total amount of recovery funds spent.
  - Amount of recovery funds expended or obligated to projects
  - Detailed list of all projects/activities for which recovery funds were spent or obligated
  - Detailed information on subcontracts or subgrants awarded

## FTA Circular 5010.1D as it Relates to the Full Scope Review, Chapter III Reporting Requirements - ARRA grants

#### 1201(c) Reporting

- Cumulative data related to:
  - funds received,
  - contracts awarded, and
  - contracts completed since 2/17/09
- Reports are due February 17

Reporting Requirements - ARRA grants

#### 1201(c) Reporting

- \* Grant recipients shall report:
  - Number of projects put out to bid\*
  - Number of projects for which contracts have been awarded\*
  - Number of projects for which work has begun\*
  - Number of projects for which work has been completed\*

\*and the federal funds associated with each of these

Reporting Requirements - ARRA grants

#### 1201(c) Reporting

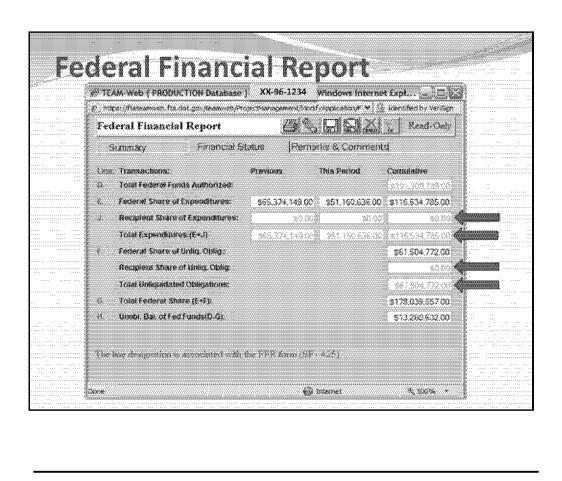
- Grant recipients shall report:
  - The amount of federal funds appropriated, allocated, obligated and outlayed under the appropriation
  - Number of direct, on-project jobs created or sustained
  - Estimated number of indirect jobs
  - Funding from state sources compared to planned levels

#### **Federal Financial Report**

- Primary source of financial information for the FTA
- FTA monitors the status of all open grants on a quarterly basis
- Key indicators of potential problems
  - Excessive unobligated balances
  - No financial activity for more than two quarters

#### **Federal Financial Report**

- Must contain all financial facts
- Reported financial data should be accurate and up-to-date
- Financial reports should be based on the required supporting documentation
- Financial data should be derived from accounts that are maintained on a consistent, periodic basis
- Reporting terminology should be consistent with approved classifications



#### Federal Financial Report Basic Requirements

Only four data elements are required for the initial reporting period\*:

- \* Total Expenditures
- Recipient Share of Expenditures (Line J)
- Total Unliquidated Obligations
- Recipient Share of Unliquidated Obligations

\*The remaining elements are scheduled to be incorporated for future reporting periods.

#### Federal Financial Report Total Expenditures

- Total Expenditures include:
  - sum of actual cash disbursed for direct charges
  - indirect expenses incurred
  - value of in-kind contributions
  - net increase (decrease) in amounts owed by the grantee (accounts payable) [applicable for those who maintain books on a cash basis.]
- Less:
  - Farebox revenues, rebates, refunds, or other credits (if operating assistance received).

## Federal Financial Report **Examples of Total Expenditures** Cash disbursements for direct charges - Project construction costs · Fuel Driver wages Other operating expenses Indirect expense incurred · Overhead costs (e.g., rent, utilities, insurance)

## **Federal Financial Report Examples of Total Expenditures** In-kind contributions Use of facilities · Land, right-of-way Services (e.g., legal, architectural) Accounts Payable Goods received, not yet paid for Accrued expenses (e.g., payroll, benefits)

#### Federal Financial Report Share of Expenditures

- Federal and recipient share of expenditures (Lines E & J)
  - Pro-rata share according to the grant agreement per each project
  - Report actual total project costs, not just up to the budgeted total costs

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### **Federal Financial Report** Total Unliquidated Obligations/ Encumbrances Obligations incurred, but for which an outlay has not yet been recorded (Line D - Federal Financial Report) Examples: Signed contract for purchase of buses, however, delivery has not yet occurred Contract for construction services not yet rendered Open purchase orders - Goods and services not yet received

#### Federal Financial Report Basic Requirements

- Prepare report on accrual basis
- Include financial activities for program of projects, including any operating assistance
- Submit report on TEAM no later than 30 days after the end of each reporting period

## Sample Grant Budget Part 3: Budget Project Budget

	Quantity	FTA Amount	Elia, Proj. Cost
SCOPE			**************************************
11101 BUS - ROLLING STOCK	1	\$3,320,000	\$4,150,000
ACTIVITY			
111304 PURCHASE < 30 FT BUS	<b>†</b>	\$160,000	\$200,000
PURCHASE 40 FT BUS 10	10	\$1,840,000	\$2,300.000
TROLLEY CARS 6	6	\$1,320,000	\$1,650,000
SCOPE			
11301 BUS - STATION/STOPS/TERMINALS	1	\$40,000	\$50,000
ACTIVITY			
113104 ENGINEERING AND DESIGN, AND ENVIRONMENTAL ASSESSMENT		\$25,000	\$31,250
113304 CONSTRUCTION OF A PARK AND RIDE LOT	1	\$15,000	\$18,750
117691 LAND ACQUISITION		50	\$0

#### **Grant Modifications--Possible Actions:**

- Administrative Amendment: change in a grant agreement initiated by FTA to clarify terms of grant
- Budget Revision: transfer of funds between or among activity line items within a Scope or Scopes in a grant
- Full Grant Amendment: change in the scope,
   purpose of Federal participation in cost of project
   (Note: full amendment essentially means a new grant)

#### Grant Budget Modification Administrative Amendment

May be used to change, or clarify the terms, conditions or provisions of a grant.

- Changes required by law
- Change year or type of funds
- Transfer equipment from one grantee to another
- Reflect change in grantee's name
- Deobligate federal funds that are no longer needed to complete approved project scope or purpose

#### **Grant Budget Modification**

#### **Budget Revision**

- Defined as any change within the scope of the original grant.
- May be a transfer of funds within a project or among projects within an approved grant.
- Could also include the addition or deletion of an activity.\*
- Cannot be used to materially change the purpose or intent, i.e., scope, or Federal dollar amount of the grant.
- When a transfer is performed between capital/operating/ planning activities, a financial purpose code (FPC) change is made by the FTA project manager. Grant recipients should be aware of this when initiating drawdowns.

#### **Grant Budget Modification**

#### **Budget Revision**

Prior approval required when:

- Federal share of the grant exceeds \$100,000 and the change in the cumulative amount of funds allocated to each scope from the originally approved scope exceeds twenty percent (20%).
- Transferring funds between activity line items (ALIs) with different Federal matching ratios, such as moving funds from capital to operating
- Changing the federal share of an existing ALL such as changing an ALL from 80/20 to 83/17 to account for compliance with requirements.

#### Grant Budget Modification Budget Revision

Prior approval required when:

- Increasing or reducing purchasing rolling stock by more than 2
  units (for grantees with fewer than 10 vehicles) or more than 20%
  from the quantity identified in the original grant
- Changing size or physical characteristics of the items in the ALIs without changing the project scope
- Adding or deleting an ALI to an existing scope included in the grant, provided there is no change in the amount of federal funds or the scope

#### **Grant Budget Modification**

#### **Grant Amendment**

- Required for:
  - Increase in Federal share
  - Change in grant scope or purpose
- Subject to the same application requirements as a new grant request

# FTA Circular 5010.1D as it Relates to the Full Scope Review, Chapter III Grant Budget Modification Grant Amendment Change in scope # Materially alter the objective of the approved project (i.e. change the scope); # Changes in rolling stock that exceeds 20%

### Things to Remember for Grant Application:

- Prepare grant scope descriptions carefully
- Anticipate problems, plan for contingencies, list alternative projects

# FTA Circular 5010.1D as it Relates to the Full Scope Review, Chapter III **Close Out Procedures** "The grantee must initiate closeout of a grant when all approved activities are completed and/or applicable Federal funds expended."

### Close Out Procedures

- Letter to FTA notifying of pending closeout
- Final FSR
- Final budget revision reflecting actual project costs
- Final narrative milestone/progress report
- Request to deobligate unexpended Federal funds
- Any other required reports

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### **Close Out Procedures**

### FTA may unilaterally initiate grant close-out if:

- Grantee fails to comply with terms or conditions of the Grant Agreement or other Federal requirements
- Continuation would not produce results commensurate with expenditures
- Funds are no longer need to accomplish the grant purpose
- Grantee fails to make reasonable progress to complete activities
- Project has been essentially completed and/or funds substantially drawn down

### Record Retention

Records must be maintained for 3 years from the start date specified below:

- The date of submission of the final FSR or, if waived, the date it would have been due
- In the event of litigation, claim, negotiation, audit or other action, after the resolution of issues
- For equipment, the date of disposition, transfer or replacement

# FTA Circular 5010.1D as it Relates to the Full Scope Review, Chapter III Record Retention

Records must be maintained for 3 years from the start date specified below:

### For indirect cost allocation plans:

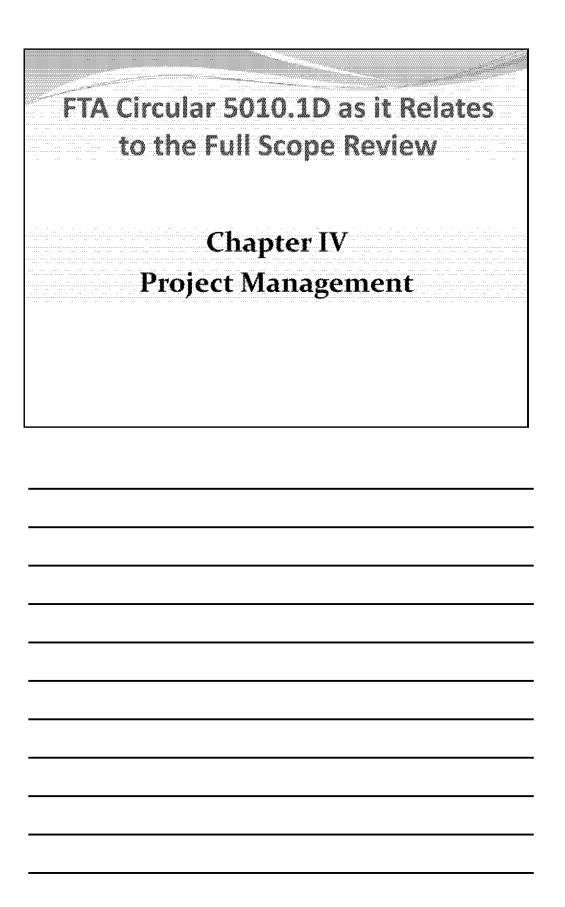
- If required to be submitted for negotiation, the date the plan is submitted to the FTA for approval
- If not required to be submitted for negotiation, the end of the fiscal year covered by the plan

### Record Retention

- Records executed electronically may be retained in that manner
- Copies made by microfilming, photocopying, or similar methods may be substituted for the original records
- Files must be accessible for review, audit or downloading to paper copy

### Record Retention

- To avoid duplicate record-keeping, FTA may make special arrangements with grantees (including subgrantees) to retain any records which are continually needed for joint use
- FTA will request transfer of records to its custody when it determines that the records possess long-term retention value
- When records are transferred to FTA, the 3-year period does not apply to the grantee



### **Chapter Topics**

- Real Property
- Equipment, Supplies & Rolling Stock
  - Useful life criteria
  - Rolling Stock Status Report
  - Overhaul vs. rebuild
  - Leasing
- Design & Construction of Facilities

### Rolling Stock Purchases Determining Useful Life

- FTA provides a useful life policy for buses, trolleys, ferries, facilities and some equipment
- Where a policy has not been defined, grantee must work with its regional office to identify one
- Grantee shall propose a useful life in the grant application
- FTA approval of the grant represents FTA concurrence of the final determination of useful life

### Rolling Stock Purchases Determining Useful Life-Acceptable Methods

- Generally accepted accounting principles (GAAP)
- Independent evaluation
- Manufacturer's estimated useful life
- \* IRS guidelines
- \* Industry standards
- Grantee experience
- Independent auditor who needs to concur
- Proven useful life developed at Federal test facility

### Rolling Stock Purchases Useful Life of Project Property

- \* Bus
- \*\* Trolley
- Rail Vehicles (at least 25 years or alternative useful life based on hours or operation)

### Rolling Stock Purchases Useful Life of Project Property

- \* Ferries- FTA recommends using one of the acceptable methods for determining useful life or one of the following suggested minimum service lives:
  - Passenger: 25 years
  - \* Other (with refurbishment): 30 years
  - \* Other (without refurbishment): 60 years
- Facilities (railroad building: 50 years; other: 40 years)

# FTA Circular 5010.1D as it Relates to the Full Scope Review, Chapter IV Bus Useful Life Policy Large, heavy duty (35/40) and articulated bisses Small heavy · Light-dary light buses · 5 years · 152,000 miles

# FTA Circular 5010.1D as it Relates to the Full Scope Review, Chapter IV Trolley Useful Life Policy Fixed guideway, steel-wheeled trolley (streetcar or other light rail vehicle) · At least 25 years Fixed guideway electric trolley-bus with rubber tires (overhead catenary) · At least 15 years Simulated trolleys, with rubber tire. ("trolley-replica buses") · Refer to bus useful life criteria.

### **Rolling Stock Purchases**

### Spare Ratio

- The number of spare buses in the <u>active</u> fleet for grantees operating 50 or more revenue vehicles should not exceed 20 percent of the number of vehicles operated in maximum service.
- FTA has not established a maximum acceptable spare ratio for rail transit operation, but offers guidance to support an operator's proposed spare ratio

# FTA Circular 5010.1D as it Relates to the Full Scope Review, Chapter IV **Contingency Fleet** No bus may be stockpiled before the vehicle has reached the end of its minimum normal service life AND Be properly stored, maintained and documented in a contingency plan

Leases - Capital Leases Any transaction whereby the grantee acquires the right to use a capital asset. A lease is a capital lease (for FTA purposes) if it cannot be cancelled AND one of the following is true:

- \* Term of lease ≥ 75% of asset useful life
- \* Lessee becomes owner at end of lease term
- Lease contains bargained for option date
- \* PV of rent=90% of value of property

Leases – Capital Leases
When grantee is lessee (leasing from another):

- Grantee must maintain an inventory of the assets
- Must record the lease liability
- Eligible lease costs include interest, legal, financial advisor, delivery, installation, and maintenance costs.


# FTA Circular 5010.1D as it Relates to the Full Scope Review, Chapter IV Disposition Replacement at End of Normal Useful Life Disposition Before End of Useful Life Retain and Use Elsewhere Like-Kind Exchange Policy Transfers from Grantee-to-Grantee Insurance Proceeds

### Fair Market Value Over \$5,000

- After the service life of project property is reached, rolling stock and equipment with a current market value exceeding \$5,000 per unit, or unused supplies with a total aggregate fair market value of more than \$5,000, may be retained or sold
- Reimbursement to FTA shall be the aggregate market value at time of disposition multiplied by the percentage of FTA's participation

### Fair Market Value Less Than \$5,000

- "After the service life of project property is reached, rolling stock and equipment with a unit market value of \$5,000 or less, or supplies with a total aggregate fair market value of \$5,000 or less, may be retained, sold, or otherwise disposed of with no obligation to reimburse FTA."
- Records of this action must be retained.

### **Force Account**

- The use of use of a grantee's own labor force to carry out a capital grant project
- May consist of design, construction, refurbishment, inspection and construction management activities if eligible under the grant
- Does not include grant or project administration activities
- May include major capital project work on rolling stock (meaning some preventive maintenance)

### Force Account

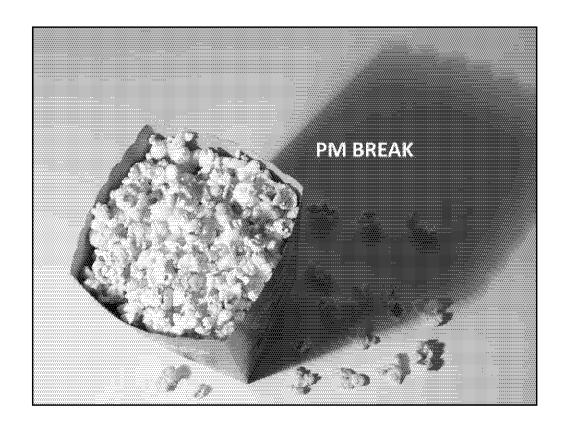
One of 4 conditions may warrant the use of a grantee's own labor forces. These are:

- \* cost savings
- exclusive expertise
- safety and efficiency of operations
- \* union agreement

An FTA approved force account plan is required when force account is >\$10,000,000. If force account is <\$10,000,000 and >\$100,000 a plan is required to be on file but not approved by FTA

Force Account, Basis for Reimbursement

- Justification
- Force Account Plan
- Scope of Work
- Construction Plans
- Basis for determination
- Present value of cash drawdown for both force and private sector
- All costs: documents, administration, inspection, etc.
- Unit prices for labor, materials, equipment and profit for private contract
- Certification that costs are fair and reasonable
- Analysis of availability
- Union agreement citations



### General Reviews

- Triennial Review
- State Management Review

### Project Level Reviews

- Project ManagementOversight
- Financial Capacity

### Program-Specific Reviews

- Financial ManagementOversight Reviews
- Procurement
- Civil Rights
- Safety & Security

# FTA Circular 5010.1D as it Relates to the Full Scope Review **Chapter VI Financial** Management

### **Chapter Topics**

- \* Internal Controls
- \* Local Match
- Financial Plan
- Indirect Costs
- General Principles for Determining Allowable Cost
- Program Income
- Annual Audit
- \* Payment Procedures
- De-obligation of funds
- Debt Service Reserve
- FTA Right to Terminate

### Internal Controls:

 New link to the internal control self-assessment tool on the FTA website.

http://www.fta.dot.gov/documents/FTA\_Internal\_Control\_Self -Assessment\_Tool.pdf

### Local Match - Grantee agrees:

- To provide sufficient funds or approved in-kind resources to serve as local match for all federally-assisted projects
- Those funds will be available as project costs are incurred or become due (except when permitted by FTA in writing to defer local share)

- Financial Plan
  - Upon request, grantee must provide a financial plan delineating:
    - Source of local share
    - Amounts applicable to the different sources
    - Time frame for acquisition of local share
  - Grantee shall have multi-year financial plans that project operating and capital revenues and expenses
    - 3-5 years for non-New Starts
    - 20 years if involved in New Starts project

### **Annual Audit:**

- One copy of Single Audit must be submitted to FTA if the report contains any findings or recommendations related to the FTA program or other DOT program findings
- One copy of the Data Collection Form must be submitted if there are no FTA findings or recommendations
- The audit cannot be closed until FTA concurs on corrective action
- The status of outstanding findings and recommendations should be monitored and reported by the grantee in the quarterly progress reports and significant events reports (where appropriate)

### **Program Income**

### Definition

- Gross income received by the grantee or subgrantee directly generated by a grant supported activity or
- Earned only as a result of the Grant Agreement during the grant period

### Use

\* Grantees may retain program income and use it for capital and operating purposes. Program income may not be used to reduce the local share of the grant from which it was earned, but may be used in future grants.

### FTA Circular 5010.1D as it Relates to the Full Scope Review, Chapter VI

#### **Program Income Grantees May Retain:**

- \* Fees for services performed
- \* The use or rental of real or personal property acquired with grant funds
- The sale of commodities or items fabricated under a Grant Agreement
- Payment of principal and interest on loans made with grant funds

This discussion of 4220.1F focuses on issues surrounding testing allowable costs. It is not intended to replace formal procurement training.

#### FTA Circular 4220.1F as it Relates to the Full Scope Review-Organization Chapter I · Introduction and Role of FTA Chapter II · Applicability Chapter III · Recipient's Responsibilities Chapter IV · Recipient's Property and Services Needs Clampter V Sources Chapter VI · Procedural Guidance for Open Market. **Procurements** Protests, Changes and Modifications, Disputes, Chapter VII Claims, Litigation, and Settlements

### FTA Circular 4220.1F as it Relates to the Full Scope Review-Organization Appendix A References FTA Regional and Metropolitan Office Contact Information Appendix B Appendix C Third Party Contracting Checklist Appendix D Federally Required and Other Model Clauses Index Subject and Location in Circular

#### **Significant Changes**

- Clarification that the circular is guidance not policy; FTA will consider alternatives if contacted before it is employed
- Change in applicability to states
- Policy related to capital, operations, and preventive maintenance contracts
- Additions to requirements for written procurement procedures
- Lease vs. Purchase Analysis
- Security for Progress Payments

#### Chapter III, Section 1-Written Standards of Conduct

"The Common Grant Rules require each recipient to maintain written standards of conduct governing the performance of its employees engaged in the award and administration of contracts."

#### Policy should address:

- Personal conflicts of interest
- \* Gifts
- Violations

- Grantee Procurement Manual does not contain code of conduct policies for employees involved in the procurement process
- Grantee had not required Directors involved in procurement activities to certify compliance with standard of conduct
- Advisory: Code of Ethics Statements not signed by employees.

# FTA Circular 4220.1F as it Relates to the Full Scope Review Chapter III, Section 3a - Written

The Common Grant Rules require the recipient to have written procurement procedures."

#### Chapter III, Section 3a – Written Procurement Procedures

Procurement Procedures are expected to address:

- Solicitations
- Necessity
- Lease vs. Purchase
- Metric Usage
- Environmental and Energy Efficiency Preferences

#### Chapter III, Section 3a – Written Procurement Procedures

Procurement Procedures should also address:

- Procurement Methods (Chapter VI)
- Legal Restrictions (Chapter IV)
- Contract Provisions (Chapter IV)
- Sources (Chapter V)
- Resolution of Contract Issues (Chapter VII)

#### Chapter III, Section 3d(1) - Written Record of Procurement History

"The Common Grant Rules require the recipient to maintain and make available to FTA written records detailing the history of each procurement, as follows:"

- Procurement Method
- \* Contract Type
- \* Contractor Selection
- Cost or price

- Grantee files did not contain adequate justification for sole source procurement
- Procurement files did not contain evidence of an independent cost or price analysis
- Grantee could not provide documentation to justify two contracts issued to one contractor

#### Chapter IV-Recipient's Needs

- Unnecessary Reserves: recipients should not
   acquire more property than it currently needs to
   support its public transportation system (i.e.,
   spare ratio)
- Assignment: recipients should only contract for current and reasonably anticipated needs

#### Chapter IV-Federal Requirements Contractor Qualifications

- Responsibility
- Debarment and Suspension
- Conflict of Interest
- Lobbying Certification and Disclosure
- Federal Civil Rights Laws
- Socio-Economic Development
- Sensitive Security Information
- Seat Belt Use

#### Chapter VI, Section 1 - Competition

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Chapter VI, Section 1 - Competition Features that unduly restrict competition

- \* Excessive Qualifications
- \* Unnecessary experience
- \* Retainers
- \* Excessive Bonding
- \* Brand Name Only

- In-state or Local
  - Geographic Restrictions
- \* Improper Pre-qualification . Organizational Conflict of
  - Interest
  - Restraint of Trade
  - Arbitrary Action

- Grantee improperly awarded a contract to a contractor who did not submit a bid.
- Grantee did not obtain a sufficient number of quotes to justify a purchase.
- Grantee included evaluation criteria that ensured selection of a particular contractor.
- Inadequate justification for an emergency procurement.

Chapter VI, Section 2a(4)(g) – In-state or Local Geographic Restrictions

Specifying in-state or local geographic preferences unduly restrict competition with the following exceptions:

- Architecture and Engineering Services
- Licensing
- Disaster Projects

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Chapter VI, Section 6 - Cost and Price Analysis

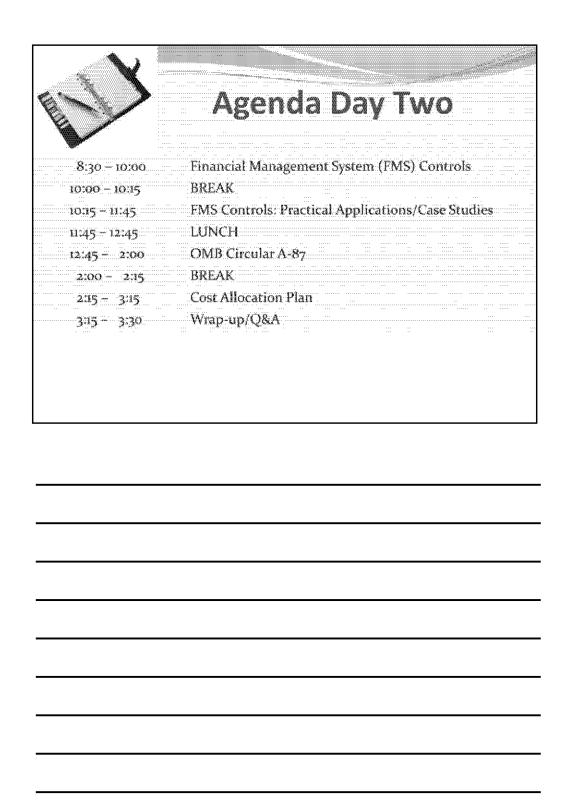
"The Common Grant Rules require the recipient to perform a cost or price analysis in connection with every procurement action, including contract modifications."

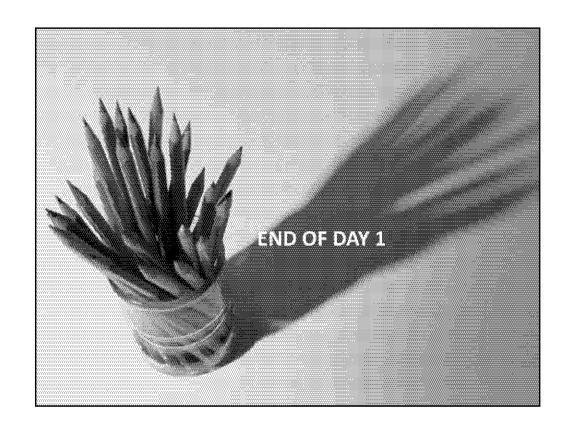
- No evidence of cost/price analysis
- Grantee policy requiring 3 independent quotes not followed
- Grantee not adhering to documentation requirements for telephone quotes

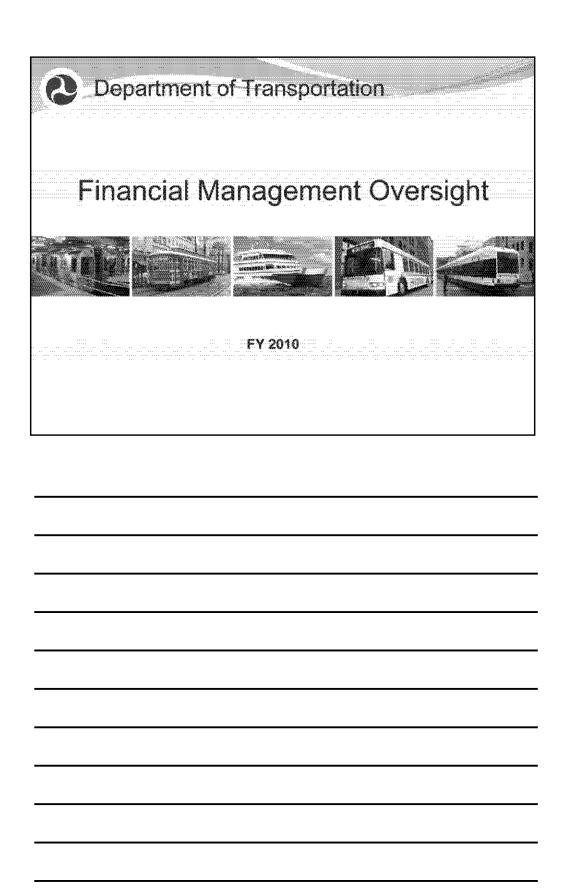
Chapter VI, Section 7-Evaluations

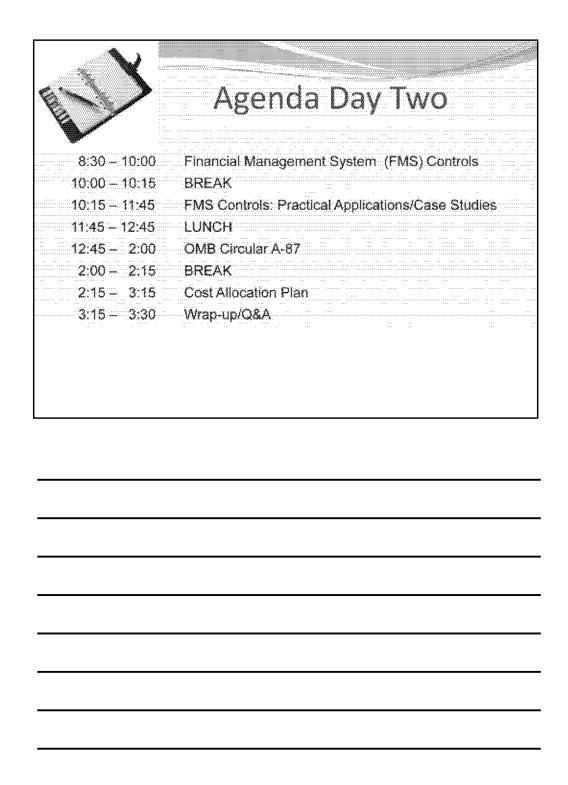
"Bids and offers must be evaluated in accordance with all the evaluation factors set forth in the invitation for bids or request for proposals. Only those evaluation factors that have been set forth in those procurement documents may be used to determine the award."

- Grantee files did not contain evaluation/ selection criteria for contracts awarded.
- \* Advisory: Evaluation criteria not weighted.











# Objectives for this Session: Briefly review some basic internal control concepts, definitions, and ideas to build upon a common understanding. Introduce and understand the components of internal control and discuss the benefits and limitations of an internal control system.

# Public View on Internal Control ■ Cascade effect of Sarbanes–Oxley Act of 2002 • Revisions to OMB Circular A-123 State Legislative Actions

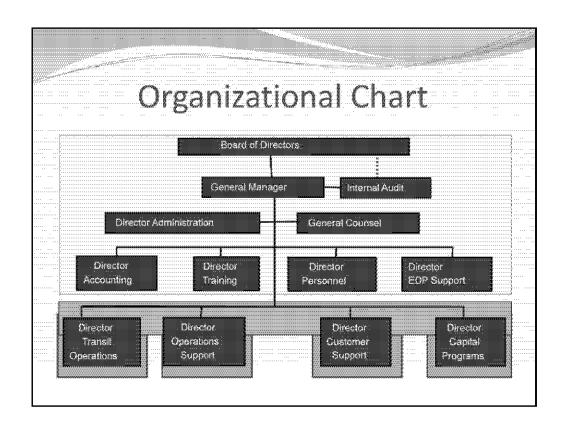
### What is Internal Control? "Internal control" is broadly defined as a process, effected by an entity's board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories: Reliability of financial reporting Compliance with applicable laws and regulations

## Committee of Spensoring Organizations (COSO) Internal Control Framework

- The Committee of Sponsoring Organizations (COSO) of the Treadway Commission has published Internal Control-Integrated Framework
- It emerged as the framework that management and auditors use to evaluate internal controls
- Recognized control framework established by a body of experts

# Five Elements of Internal Control Control Environment Risk Assessment 3. Control Activities 4. Information and Communications 5 Monitoring

# 1. Control Environment Sets the tone of an organization and is done through management Provides discipline and structure Based on the integrity, ethics and competence of management/employees Board should establish the foundation for overall direction

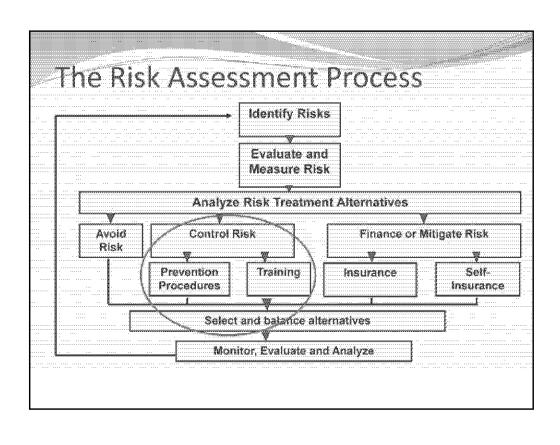


#### 1. Control Environment

- Effective control environment
  - Board of Directors and audit committee participation
  - Assignment of authority and responsibilities
  - Commitment to competence
  - Integrity and ethical values
- Control environment can reduce effectiveness of other components
  - Management incentives could result in material misstatement of financial statements
  - Internal control can be affected by changes in management and developments in the industry, such as cuts in funding.

### 2. Risk Assessment Process for identification, analysis, and management of risks relevant to the preparation of financial information Risks arise due to change in circumstances such as: New personnel New or revamped information systems Growth New fare collection process or system Organizational restructuring New accounting pronouncements Reduction in funding « Shifts in transit industry - rider demographics and spending patterns

#### Risk Assessment Process Identify resources and critical factors necessary to achievé objectives such as: Financing Personnel • Facilities Services Technology Consider risk from external sources such as: Creditor demands Natural events Regulation Supply sources Public approval for funding increases \* Prioritize risk identified for purposes of mitigating them



### 3. Control Activities Policies and procedures that ensure management directives are carried out Occur throughout the organization, all levels, functions, timely basis Include approvals, verifications, reconciliations, review of actual vs. budget reports, etc. Segregation of duties Safeguarding of assets Information processing

### 4. Information and Communication Pertinent information identified, captured, and communicated Timely Financial and operational Compliance related Internal and external Down, up and across agency

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### Applications to Small and Mid-sized Grantees

- Implementation of control environment factors is different
- Less formal structure, but emphasize culture of integrity through oral communication and management example
- Smaller entities rely more on compensating controls due to the low number of personnel

# **Designing Good Controls** Good internal controls are designed to segregate these generally incompatible functions: Authorization to execute Recording of exchanges timely Safeguarding of assets Accountability and review of activities/accounts

# Limitations on Internal Control Human judgment in decision-making can be faulty Circumvented by collusion of two or more people Management override

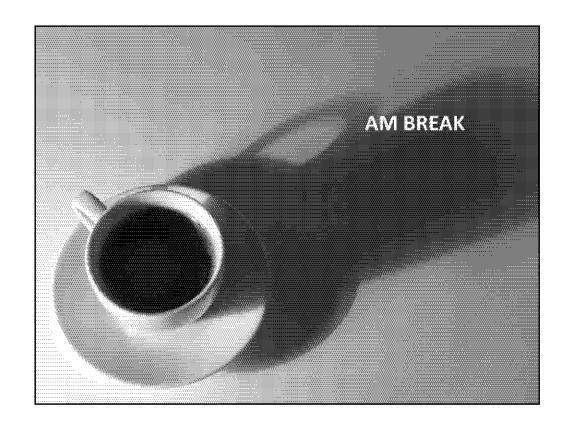
# Internal Control Weakness When weaknesses are found in control systems or specific controls, choices must be made among the following alternatives: Instituting new controls Improving existing controls Accepting the risk inherent in the weakness

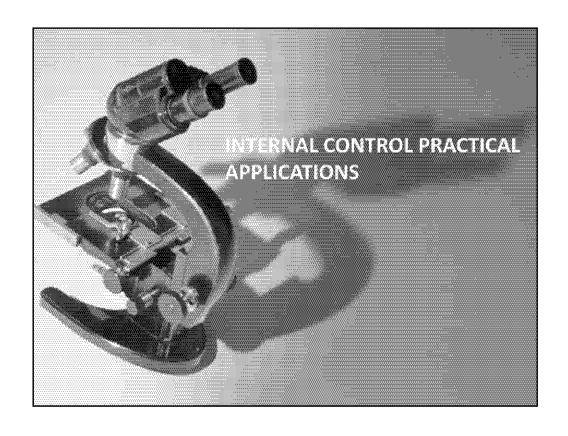
### Cost/Benefit Analysis To quantify the risk of a control weakness, certain assessments must be made: The likelihood of the error occurring: Probability that it will occur at any point Estimated frequency of occurring Magnitude of the potential error Significance of the weakness in terms of potential loss must be compared to the cost of any new or revised control.

### **Elimination of Obsolete Controls** Systems change - controls should too Controls are often added to systems on top of other controls Eliminate redundant or cost-ineffective controls Too many controls slow system, waste resources, reduce customer service Consider laws and regulations before eliminating controls Build controls into processes

### What is the Future for Internal Controls?

- Greater emphasis on process controls over transaction controls (e.g., FMO Review)
- Paperless transactions
- More use of technology
- Focus on fraud risk factors
- Indirect impact of Sarbanes-Oxley





#### Key Accounts and Transaction Classes



- Cash Management
- Fixed Assets
- Procurement
- \* Accounts Payable
- Payroll

- Overhead
- Budget Controls
- **Grants Management**
- Project Management
- Information Technology


### **Cash Management** \* Cash Receipts: Are controls over cash received in the organization adequate to ensure that all receipts are deposited in accordance with company policy? \* Fare Revenues: Are fare revenue collection procedures controlled in a way that minimizes access to cash and exposure to theft? Cash Disbursements: Are cash disbursements controlled in a way that limits access to checks and other instruments that are easily convertible to cash?

### **Cash Management** \* Cash Receipts: Checks received by someone independent of accounts receivable accountant or other accounting personnel who initiate or post journal entries ■ Fare Revenues: Cash counts reconciled to farebox reports Cash Account Reconciliation: Are cash accounts reconciled to ensure proper recording, timely identification and appropriate follow up of errors or irregularities?

## **Fixed Assets** - Recording: Does the organization have written policies and procedures that ensure the completeness and accuracy of fixed assets information? Fixed Assets Inventory: Is a physical inventory performed in accordance with FTA regulations and reconciled to fixed assets records? \* Fixed Assets Disposals: Are disposal procedures adequate to ensure proper control of assets through disposition?

# **Fixed Assets** • Fixed Assets Safeguards: Are assets adequately protected against loss or theft both physically and financially? \* Fixed Assets Maintenance: Do agency controls ensure that vehicles are maintained in serviceable condition throughout their useful life? Spare Parts: Are spare parts adequately safeguarded against loss?

## **Procurement** \* Assessment of Need: Are controls in place to ensure that only reasonable and necessary goods and services are purchased? \* Procurement Structure: Are procurements structured to allow fair and open competition to the extent possible? Vendor Qualification: Does the organization perform procedures to ensure that vendors have the ability to perform in accordance with the contract?

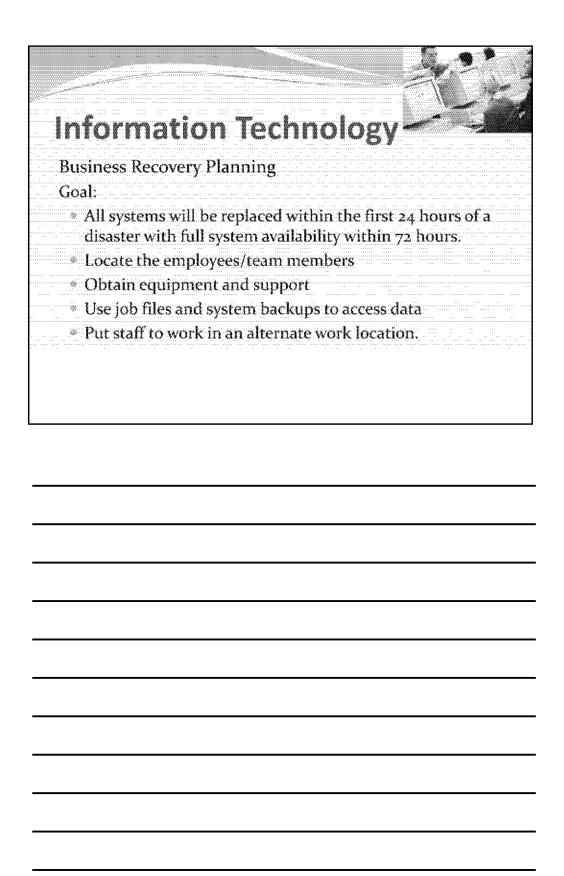
## Procurement \* Procurement Structure: Are independent cost estimates developed before receiving bids or proposals? Vendor Qualification: Is there an approved vendors list that includes pre-qualified vendors? \* Vendor Selection: Are the written selection procedures used for each type of procurement? Civil Rights: Do the agency's procurement policies ensure that M/W/DBE's are used whenever possible?

## Procurement Contract Modifications: Are procedures in place to ensure that the need for modifications is properly evaluated? Dispute Resolution: Does the organization have adequate dispute resolution procedures? \* Conflicts of Interest: Does the agency have clear, written policies regarding conflicts of interest for employees representing the agency's interest?

# **Grants Management** Grant Records: Is the grants management system sufficiently controlled to ensure that: Only allowable grant expenditures are charged? The grants management system is reconciled to the general ledger and TEAM periodically? Encumbrances: Does the system allow for accurate tracking of encumbrances?

# **Grants Management** Grant Reporting: Are FSRs prepared on the accrual basis as required by FTA? Budget Revisions: Are there formal procedures to ensure revisions are made only when authorized and justified? \* Grant Close-Out: Are the agency's procedures sufficient to ensure timely close-out of grants in accordance with FTA regulations?

### Information Technology Are controls over Information Technology sufficient to: Ensure that hardware and software are protected against loss or misuse? Ensure that access to sensitive data is restricted? Reduce the risk of unauthorized transactions occurring and not being detected? Ensure that critical data is protected in the event of emergency?

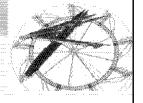




**Business Recovery Planning** 

A comprehensive plan should cover the following areas:

- \* Personnel Information: Including contact information, safety, and ability to resume work
- \* Systems: Orderly shutdown of equipment, resumption of mission-critical processing, and location of backups
- Processes: Documentation of critical business processes and process requirements

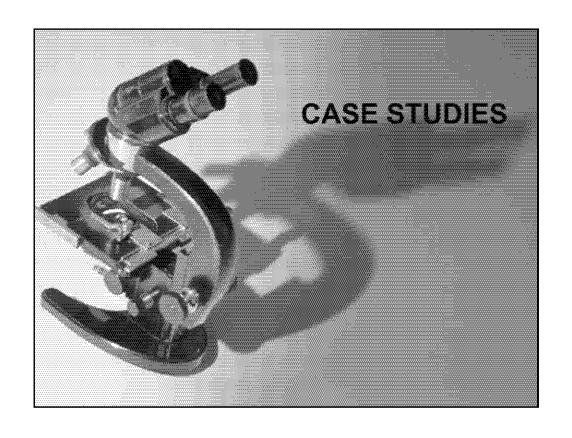


#### Information Technology

**Business Recovery Planning** 

A comprehensive plan should cover the following areas:

- Communications: Protection of networks, telecommunications, and data services along with alternatives
- Vital Records (Data and Paper): Preservation of information security, and rapid restoration documentation
- Facilities: Safeguarding of facilities, and rapid re-entry or relocation
- \* Vital materials: May include spare parts



#### **Case Study #1: Control Environment**

#### Condition

Overall, Anywhere Transit's control environment appeared to have been functioning properly. The grantee had documented procedures that were supposed to be followed throughout the procurement process in its Procurement Policy and Procedures Manual. The manual detailed advertising procedures, authorizations that must be obtained for each procurement type, and documentation that must be maintained to support the history of all significant procurements. At the time of the FMO review, midlevel managers confided that there were times when the General Manager pressured them to sign documents they were not comfortable signing and had overridden the procurement process on a major transaction. Upon review of the procurement records for that transaction, no cost or price analysis was included in the procurement file and the files lacked selection criteria and documentation supporting the advertised Request for Proposal. If the staff offered assistance or attempted to provide information that may assist in ensuring that the procurement complied with federal regulations, he dismissed their assistance and raised his voice at them for daring to disrupt his progress.

What is the problem?

What caused this problem?

#### **Case Study #2: Control Activities**

#### Condition

During a review of balance sheet accounts of Grantee X, it was noted that formal reconciliations were not performed. A formal reconciliation compares the balance per the detail subsidiary ledger to the balance per the general ledger and indicates any resulting difference and its resolution. In most cases, the differences require resolution by making adjustments to the appropriate record. Based on the review of the accounts receivable aging and the accounts payable aging reports, the reconciliations were not done. Furthermore, the reconciliations performed for the fixed assets and cash accounts indicated large differences that had gone unresolved for several months. For example, a review of three of the bank reconciliations for the general fund indicated that a \$10,000 difference remained unresolved for at least nine months without any explanation.

In addition, deferred revenue for tokens had not been analyzed for several years and appears to be overstated. Furthermore, during the review of Transpass sales it was noted that a schedule of sales and returns is prepared by the Sales Coordinator. However, this schedule is not being reconciled to the general ledger.

What is the problem?

What caused this problem?

#### **Case Study #3: Control Activities**

#### **Condition**

The Assistant Accounting Director of Grantee Y receives cash and prepares the deposit slip for cash receipts. A copy of the deposit slip and related documentation is given to an accountant for posting. The same accountant also performs the bank reconciliation of the general fund cash account to the general ledger. Then the Assistant Accounting Director reviews the posting and bank reconciliation prepared by the accountant. The Assistant Accounting Director is responsible for the custody, recording, authorization and reconciliation functions.

What is the problem?

What caused this problem?

#### **Case Study #4: Control Activities**

#### **Condition**

The sales coordinator at Grantee Z is responsible for ordering, maintaining, and distributing passes and tokens to the sales representatives. The sales coordinator also documents the sale and return of passes and tokens. Also, the sales coordinator receives remittances and unsold passes from the customers.

What is the problem?

What caused this problem?

#### **Case Study #5: Information and Communications**

#### **Condition**

Due to staff turnover and accounting software challenges, Grantee A was unable to perform timely month-end general ledger closings. As a result, month-end closings for the period October 31, 2006 through February 28, 2007 were not completed until May 2007. Timely month-end general ledger closings facilitate management's ability to adequately assess financial activities and detect errors or misstatements in financial statements.

We noted during our review that the budget versus actual analysis report for March 31, 2007 was finalized on June 13, 2007 and completed prior to the month-end close of the general ledger, which occurred on June 25, 2007. As a result, several differences were noted between the analysis report and general ledger. The differences were due to subsequent adjustments.

In addition to the above, Grantee A was having financial difficulties. They were at a point where financial decisions must be made regarding the level of service the organization was able to sustain or whether the organization could even continue as a going concern. The board made these pertinent decisions based on the information in the financial reports.

What is the problem?

What caused this problem?

#### INTERNAL CONTROL SELF-ASSESSMENT FORM (FOR FTA GRANTEES)

AGENCY NAME:		
DATE OF ASSESSMEN	NT:	
Instructions:		
•	gned to provide transit agency management staff agency's internal control and financial managemen	
Integrated Framework Treadway Committee (t management systems est	e criteria for effective internal control as set forth published by the Committee of Sponsoring Cathe COSO Report), as well as the criteria for tablished by FTA, based on 49 <u>CFR</u> Part 18, <i>Units and Cooperative Agreements to State and Local</i>	Organizations of the or effective financial niform Administrative
This form is most useful control concepts.	when completed by individuals who have an und	erstanding of internal
N/A). The questions ha satisfactory degree of into	answered by a check mark in the appropriate care been prepared so that a positive (YES) an ernal control. A negative (NO) answer will indicate addressed if compensating controls do not alread	swer will indicate a ate a potential control
This form is divided into	six major sections:	
<u>Section</u>	<u>Title</u>	<u>Page</u>
I.	Control Environment	2
II.	Risk Assessment	6
III.	Control Activities	8
IV.	Information and Communications	10
V.	Monitoring	12
VI.	Key Accounts and Transaction Classes	14
This Internal Control Self	f-Assessment Form has been prepared and reviewe	d, as follows:
Prepared by	Date	

#### SECTION I—CONTROL ENVIRONMENT

Section I of the form is designed to help the transit agency evaluate its overall control environment, which sets the tone of the organization and influences the control consciousness of its employees. The control environment encompasses the following factors:

- Integrity and ethical values
- Commitment to competence
- Board of directors or audit committee participation
- Management's philosophy and operating style
- The agency's organizational structure
- Assignment of authority and responsibility
- Human resource policies and practices

		YES	NO	N/A
1.	Does agency management adequately convey the message that integrity cannot be compromised?			
2.	Does a positive control environment exist, whereby there is an attitude of control consciousness throughout the agency (e.g., checks and balances, authorizations and approvals, segregation of duties, etc.), and a positive "tone at the top?"			
3.	Is the competence of the agency's employees commensurate with their responsibilities?			
4.	Is management's operating style (the way it assigns authority and responsibility, and organizes and trains its employees) generally embraced by the agency's employees?			
5.	Does management fully understand the requirements of laws and regulations pertinent to its business, and in particular the financial management system requirements established by FTA based on 49 <a href="CFR">CFR</a> Part 18, <i>Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Government</i> (the "Common Rule")?			
6.	Does agency management carefully consider the potential effects of taking unusual business risks or entering into non-routine financial transactions (e.g., innovative financing techniques)?			
7.	Are financial statements prepared, approved, and submitted for review to management, the board of directors, or the audit committee at regular intervals?			

YES NO

N/A

		YES	NO	N/A
22.	Are individuals with sensitive positions or access to sensitive financial information required to sign security agreements and/or confidentiality agreements?			
23.	Are personnel policies and employee benefit plans documented (written) and communicated to employees?			
24.	. Is there a formal (written) conflict of interest policy or code of conduct in effect?			
25.	Are employees who handle cash, securities, and other valuable assets bonded?			
26.	Do related employees, if any, have job assignments that minimize opportunities for collusion?			
27.	Are employees adequately trained to meet their assigned responsibilities?			
28.	Does the agency require a minimum level of annual training for all employees throughout the agency?			
29.	Are there procedures in place to monitor and document training received for all employees?			
30.	Are employees cross-trained to perform the duties of others during periods of absence (vacation, sick leave, etc.)?			
31.	. Is rotation of duties enforced by mandatory vacations?			
32.	. Is job performance periodically evaluated and reviewed with employees?			
33.	. Has management established policies and procedures for development, modification, and use of computer programs and data files?			
34.	. Does the agency have a board of directors or audit committee? If yes:			
	a. Is the board or committee sufficiently independent of agency management?			
	b. Does the board or committee take an active role in overseeing the agency's policies and practices?			

		YES	NO	N/A
c.	Does the board or committee approve the appointment of the agency's independent auditors?			
d.	Does the board or committee have sufficient knowledge, experience, and time to serve effectively?			
e.	Does the board or committee constructively challenge management's planned decisions and take appropriate action if necessary (for example, conducting special investigations)?			
f.	Does the board or committee meet in a timely manner with the chief accounting officer and internal and external auditors to discuss the reasonableness of the financial reporting process, the system of internal control, and other significant matters?			
g.	Does the board or committee review the scope of activities of the external and internal auditors at least annually?			
h.	Does the board or committee regularly receive and review key information, such as financial statements, major marketing initiatives, significant contracts, and negotiations?			
i.	Does a process exist for informing the board or committee in a timely manner of sensitive information, investigation, and improper acts (e.g., significant litigation, investigations by regulatory agencies, embezzlement, misuses of corporate assets)?			
j.	Is there appropriate oversight in determining the compensation and benefits of executive officers?			
k.	Is the board or committee sufficiently involved in establishing and evaluating the effectiveness of the "tone at the top" (e.g., approving the agency's code of conduct or its policies and procedures manual)?			

#### SECTION II—RISK ASSESSMENT

Section II of the form is designed to help the agency evaluate its risk assessment process, which is the agency's process for "identification, analysis, and management of risks relevant to the preparation of financial statements and financial reports that are fairly presented in conformity with generally accepted accounting principles." Risks can arise or change due to circumstances such as the following:

- Changes in operating environment
- New personnel
- New or revamped information systems
- Rapid growth
- New technologies
- New business models, products, or services
- Organizational restructuring
- New accounting pronouncements

		YES	NO	N/A
1.	Has management established clear agency-wide objectives and are they consistent with its business plans and budgets?			
2.	Has management established objectives for key activities and are they consistent with and linked to the agency-wide objectives and strategies?			
3.	Has agency management identified the resources and critical factors that are important to achieving its objectives (e.g., financing, personnel, facilities, technology, etc.)?			
4.	Does agency management consider risks arising from external sources (e.g., supply sources, creditors' demands, regulation, natural events)?			
5.	Does management consider risks arising from internal sources (e.g., retention of key personnel or changes in their responsibilities, compensation and benefit programs to keep the agency competitive, the adequacy of back-up systems in the event of failure of systems that could significantly affect operations)?			
6.	Does management identify risks to key business functions and prioritize them for purposes of mitigating them?			
7.	Does management identify and monitor significant shifts in the transit industry (e.g., changes in rider demographics, preferences, or spending patterns)?			

		YES	NO	N/A
8.	Does agency management consult with its legal counsel regarding the implications of any new legislation?			
9.	Are new employees in key positions adequately supervised to ensure that they understand and perform in accordance with the agency's policies and procedures?			
10	Are procedures in place to assess the effects of new or redesigned information systems and to monitor new technologies?			
11	Are procedures in place to handle rapidly increasing volumes of information and to filter the most relevant data for decision making?			
12	When considering development of new or expanded transit services, does agency management give appropriate consideration to major factors such as customer demand, service delivery capabilities, and cost/revenue implications?			
13	Are staff reassignments and/or staff reductions appropriately analyzed for their potential effect on operations or on the morale of the remaining employees?			
14	Is management aware of the existence of new accounting or reporting pronouncements and how they may affect the agency's financial reporting practices?			

## SECTION III—CONTROL ACTIVITIES

Section III of the form is designed to help the agency evaluate its control activities. Control activities are the policies and procedures that help ensure management's directives are effective in processing and preparing financial statements and other required financial reports. To successfully address risks and achieve its objectives, agency management must institute various control activities, such as segregation of duties, physical controls, and a system of approvals.

		YES	NO	N/A
1.	Does agency management have clear objectives in terms of budget, revenue, cost, and other financial and operating goals? If yes, are such objectives:			
	a. Clearly written?			
	b. Actively communicated throughout the agency?			
	c. Actively monitored?			
2.	Do the planning and reporting systems in place:			
	a. Adequately identify variances from planned performance?			
	b. Adequately communicate variances to the appropriate level of management?			
3.	Does the appropriate level of management:			
	a. Adequately investigate variances?			
	b. Take appropriate and timely corrective action?			
4.	Does the agency have a documented system for ensuring that financial and accounting records are proper, complete, orderly, and well-maintained?			
5.	Has management established procedures to prevent unauthorized access to, or destruction of, documents, records, and assets?			
6.	Are there procedures in place to ensure that terminated employees' access to documents, records, and assets is appropriately restricted?			
7.	Has management established record retention policies that conform to FTA's grant/Common Rule requirements?			

		YES	NO	IN/A
8.	Has management established policies for controlling access to computer programs and data files?			
9.	Does management regularly monitor such policies?			
10.	Is the general ledger/accounting system substantiated and updated on a monthly basis, in a timely and accurate manner, with appropriate reviews and approvals?			
11.	Are amounts recorded by the accounting system periodically compared with physical assets?			
12.	Are control and subsidiary accounts reconciled regularly and discrepancies reported to appropriate personnel?			
13.	Are signatures required to evidence the performance of critical control functions, such as reconciling accounts?			
14.	Are general journal entries and reclassification entries, other than standard entries, required to be signed and approved by a responsible official not involved with their origination?			
15.	Are accounting estimates and judgments made only by knowledgeable and responsible personnel?			
16.	Does the accounting system provide in a timely manner the necessary information for the preparation of financial statements and related disclosures, as well as other required financial reports (internal and external), in accordance with generally accepted accounting principles or another comprehensive basis of accounting?			
17.	Does the accounting system maintain sufficient detail regarding FTA grant activities, and the source (i.e., grant number) and application of FTA grant funds?			
18.	Are financial statements and related disclosures, as well as other required financial reports (internal and external), prepared and reviewed by competent personnel who are knowledgeable of the factors affecting the organization's financial reporting requirements?			

#### SECTION IV—INFORMATION AND COMMUNICATIONS

Section IV of the form is designed to help the agency evaluate its information and communication systems. Information is identified, captured, processed, and reported by information systems. Relevant information includes industry, economic, and regulatory information obtained from external sources, as well as internally generated information.

Communications are inherent in information processing. Communications involve providing a clear understanding of individual roles and responsibilities in an effective manner. This may be accomplished through policy manuals, accounting manuals, or other means, and can be made orally.

		YES	NO	N/A
Inj	formation			
1.	Does the agency have mechanisms in place to obtain relevant external information (e.g., on market conditions, legislative or regulatory developments, and economic changes) and internally generated information critical to the achievement of the agency's objectives?			
2.	Is the information provided to the right employees in sufficient detail and on time to enable them to carry out their responsibilities efficiently and effectively?			
3.	Is the development or revision of information systems over financial reporting based on a strategic plan and interrelated with the agency's overall information systems, and is it responsive to achieving the agency-wide and activity-level objectives?			
4.	Does agency management commit the appropriate human and financial resources to develop the necessary financial reporting information systems?			
Co	mmunications			
1.	Does agency management communicate employees' duties and control responsibilities in an effective manner?			
2.	Are there communication channels and procedures in place for people (employees and other parties) to report suspected improprieties?			
3.	Do communications flow across the agency timely (e.g., from maintenance to accounting/finance) to enable employees to discharge their responsibilities effectively?			

		YES	NO	N/A
4.	Does agency management take timely and appropriate follow-up action on communications received from customers, vendors, FTA, other regulators, and/or other external parties?			
5.	Do other parties outside the agency review and follow up on the agency's actions and/or requirements (e.g., an active review of bank loan agreements)?			

## SECTION V—MONITORING

Section V of the form is designed to help the agency evaluate its monitoring system. Monitoring is a process that assesses the quality of internal control performance over time. It involves:

- Timely evaluation by appropriate personnel of the design and operation of controls
- Identifying areas of improvement and corrective actions
- Follow-up procedures to determine that necessary actions are implemented

Monitoring can be accomplished in manners such as the following:

- Ongoing internal activities
- Internal audit function
- External monitoring activities

		YES	NO	N/A
1.	Is operating information used to manage operations integrated, tied to, or reconciled with data generated by the financial reporting system (e.g., ridership data vs. recorded fare revenues, or farebox collections vs. cash balances/deposits, etc.)?			
2.	Are customer complaints:			
	a. Investigated timely?			
	b. Used as a means to identify and correct control deficiencies?			
3.	Are communications from vendors and monthly statements of accounts payable used as a method to detect potential problems?			
4.	Are internal control recommendations made by external auditors (and internal auditors, if applicable) actually implemented?			
5.	Does management receive employee feedback from training seminars, planning sessions, and other meetings on whether controls operate effectively?			
6.	Does the agency take a fresh look at the internal control system from time to time and evaluate its effectiveness? If yes:			
	a. Does the evaluation process include checklists, questionnaires, or other tools?			
	b. Are the evaluations documented?			

			YES	NO	N/A
7.		ses the agency have an internal audit function? If yes, do the internal ditors:			
	a.	Remain independent with regard to the agency's administrative, control, processing, and special project activities?			
	b.	Possess sufficient training, experience, and professional certifications (e.g., CPA, CIA, etc.)?			
	c.	Ensure that internal audit assignments are appropriate to the experience and expertise of the auditors?			
	d.	Adhere to applicable professional standards, practices, and procedures?			
	e.	Properly plan and supervise their work to ensure that the quality of the workpapers meets applicable standards?			
	f.	Have an adequate documentation of the agency's system of internal controls?			
	g.	Perform tests of controls and substantive tests?			
	h.	Have sufficient documentation of their work?			
	i.	Submit reports on their findings to the board of directors or audit committee (rather than the general manager or executive director) in a timely manner?			
	j.	Follow up on corrective actions taken by management?			
	k.	Have direct access to the board of directors or audit committee?			
	1.	Have direct access to records, and the scope of their activities is not limited?			

# SECTION VI—KEY ACCOUNTS AND TRANSACTION CLASSES

Section VI of the form is designed to help the agency evaluate its control activities for key accounts and transaction classes that impact upon FTA grants and grant activities.

<b>C</b> A	CASH MANAGEMENT		NO	N/A
Ca	ash Receipts			
1.	Is the agency's mail opened by someone other than the cashier, accounts receivable accountant, or other accounting employees who may initiate or post journal entries?			
2.	Is the delivery of unopened business mail prohibited to employees having access to the accounting records?			
3.	Does the employee who opens the mail:			
	a. Place restrictive endorsements (e.g., For Deposit Only) on all checks received?			
	b. Prepare a list of the money, checks, and other receipts?			
	c. Forward all remittances to the person responsible for preparing and making the daily bank deposit?			
	d. Forward the total of all remittances to the person responsible for comparing it to the authenticated deposit ticket and amount recorded?			
4.	Is there an independent listing of cash receipts prepared before the receipts are submitted to the cashier or accounts receivable accountant?			
5.	Does an independent person verify the cash receipts listing against the deposit slips?			
6.	Are authenticated deposit slips retained and reconciled to the corresponding amounts in the cash receipts records?			
7.	Are cash receipts deposited intact daily?			
8.	Is the bank deposit made by someone other than the cashier or the accounts receivable accountant?			

<b>C</b> A	CASH MANAGEMENT		YES	NO	N/A
9.		cash sales occur for other than fare revenues (e.g., monthly passes, e.)? If yes:			
	a.	Are cash receipts pre-numbered?			
	b.	Is an independent check of pre-numbered receipts done daily and reconciled to cash collections?			
	c.	Are cash register tape totals reconciled to amount of cash in drawer?			
	d.	Do cash refunds require approval?			
10	. Is	the accounts receivable accountant restricted from:			
	a.	Preparing the bank deposit?			
	b.	Obtaining access to the cash receipts book?			
	c.	Having access to collections from customers?			
11		e banks instructed not to cash checks that are drawn to the order of eagency?			
12		the cashier restricted from gaining access to the accounts receivable cords and bank and customer statements?			
13		bes the agency have multiple funding sources that are used to fund operations and capital projects? If yes:			
	a.	Are there formal (written) procedures in place to ensure that funds due from all funding sources (federal, state, local) are requisitioned and received timely?			
	b.	Is the requisitioning function performed by employees who are independent of the cash receipts function?			
14	(E	e there formal (written) procedures in place to ensure that ECHO lectronic Clearinghouse Operations) requests for FTA grant funds a made in a way that does not violate federal policy (i.e., the three-y rule)?			
15	. Is 1	there a log of ECHO requests maintained?			

ASH MANAGEMENT		NO	N/A
16. Is the responsibility for making ECHO requests segregated from the responsibility for approving requests and reconciliations (both bank account and grant reconciliations)?			
17. Is the ECHO log reconciled regularly to cash receipts reflected on the monthly bank statements by a person independent of the cash receipt and accounts receivable functions?			
18. Are ECHO drawdowns reconciled periodically to the amounts reflected as grant disbursements in FTA's TEAM (Transit Electroni Award and Management) system?	c		
19. Are there formal (written) procedures in place to ensure that no more than the allowable federal portion is drawn down?	re		
20. Does a person independent of the cash receipts and accounts receivable functions compare entries to the cash receipts journal with	th:		
a. Authenticated bank deposit slips?			
b. Deposit per the bank statements?			
c. Listing of cash receipts prepared when mail is opened?			
d. ECHO request log?			
21. Is information adequately captured from remittances for accurate posting of credits to customer accounts or for proper classification regarding its sources (e.g., grant number)?			
22. Do postings to the general ledger control accounts and subsidiary accounts include the date on which the remittance was received?			
23. Are postings to the general ledger made by a person independent of cash receipts and accounts receivable functions?	the		
24. Does a responsible official, senior to the accounts receivable accountant, approve journal entries affecting accounts receivable?			
25. Are employees with accounts receivable responsibilities required to take vacations, and are other employees cross-trained to perform the functions when an accounts receivable employee is absent?			

<b>C</b> A	CASH MANAGEMENT		NO	N/A
Fa	are Revenues			
1.	Is cash collected from fareboxes regularly and often?			
2.	Does the agency restrict cash from being physically handled by drivers/operators?			
3.	Are there procedures in place to control cash collected by drivers/operators in the farebox?			
4.	Are there formal (written) procedures for processing and counting cash once collected from the fareboxes?			
5.	If cash counting is performed:			
	a. Internally:			
	i. Are there controls in place to ensure that all cash is counted?			
	ii. Are the areas where physical handling of cash takes place (e.g., the "money room") reasonably safeguarded?			
	b. Externally:			
	i. Has the agency satisfied itself that proper internal controls at the external organization are in place and functioning as intended?			
	ii. Has the agency reevaluated the controls at the external service organization on a regular basis?			
6.	Are the results of the cash counts reconciled daily to the farebox reports by a person independent of the cash receipts and cash counting functions?			
7.	Is revenue cash transported to the bank by a person independent of the cash receipts function?			
8.	Are postings of fare revenues to the general ledger income accounts made by a person independent of the cash receipts and cash counting functions?			

# **CASH MANAGEMENT** YES NO N/A Cash Disbursements 1. Are all cash disbursements made by check except those made from petty cash? 2. Are pre-numbered checks used and all check numbers accounted for? 3. Are voided checks properly defaced and retained? 4. Are dual signatures required on checks over a predetermined amount? If yes: a. Are the check signers independent of each other? b. Are invoices, vouchers, and other supporting documents presented to each check signer along with the checks needing signature? 5. Is signing of checks in advance or in blank prohibited? 6. Are checks payable to "Cash" or "Bearer" prohibited? 7. Is access to unused checks limited to authorized persons? 8. Is a check-signing machine used? If yes: a. At all times, are the keys, signature plate, and operation of the signing machine under control of the official whose signature is on the plate? b. Are the employees who have custody of the keys and plate, and who operate the check-signing machine, independent of checkpreparation functions and denied access to blank checks? c. Are the checks issued to the machine operator counted in advance, and reconciled with the totals indicated on the check-signing machine by someone other than the machine operator? 9. Are supporting documents for checks properly canceled (e.g., stamped "Paid") to avoid duplicate payments? 10. Do proper safeguards exist to prevent checks that have been mailed from returning to the accounts payable accountant or to the employee who drew the checks?

CA	SH	I MANAGEMENT	YES	NO	N/A
11.		the check-signing function independent of procurement, cash counting, and preparation of checks?			
12.	Ar	e check signers authorized by the board of directors?			
13.		e all checks promptly recorded upon issuance and listed in detail g., in a check register)?			
14.	Ar	e payroll checks drawn against a separate payroll bank account?			
Ca	sh 2	Account Reconciliations			
1.	me	e bank statements, canceled checks, deposit tickets, and related emos received directly from the bank by the employee performing e reconciliations?			
2.	cas	e bank accounts reconciled monthly by a person independent of the sh receipts, general ledger, accounts receivable, or accounts payable actions?			
3.	Do	bank account reconciliation procedures include:			
	a.	Accounting for the sequence of all check numbers?			
	b.	Examination of paid checks for date, name, endorsement, and cancellation and comparison to the cash disbursements journal?			
	c.	Comparison of bank deposit detail to cash receipts records?			
	d.	Investigation of other reconciling items (e.g., checks returned for insufficient funds)?			
	e.	Follow-up on old outstanding checks?			
4.	Is a	an independent review performed of monthly bank reconciliations?			
In	est	ments			
1.		bes the agency have formal (written) procedures related to cash inagement and investment of funds?			
2.		bes the agency have procedures in place to ensure that funds held in cess of FDIC limits are collateralized and protected?			

<u>CA</u>	CASH MANAGEMENT			N/A
3.	Are investment securities kept in a safe vault? If yes:			
	a. Is a record kept of all visits to the vault?			
	b. Is the presence or signature of two or more designated persons required to open the vault?			
	c. Is a detail record (e.g., certificate number, description) kept of each security?			
	d. Are the securities periodically inspected and compared with detailed investment records by employees independent of the custodian and with the general ledger?			
4.	Are all securities held in the name of the agency?			
5.	Is custody of investment securities held by the agency assigned to bonded employees?			
6.	Is the custodian of securities independent of the accounting function?			
7.	Are purchases, exchanges, sales, and pledges of investments initiated and approved by designated officers?			
8.	Are investments held in custodial accounts with a bank, trustee, or broker? If yes:			
	a. Are account statements from these parties regularly reconciled with the general ledger control account?			
	b. Is there a periodic review of the reputation and financial position of the parties that are ensuring completion of investment transactions?			
9.	Is documented management authorization of transactions compared with evidence of execution of transactions (e.g., brokers' advices) promptly, and are differences investigated?			
10.	Are procedures in place to ensure that investment income is recorded properly and collected in a timely manner?			
11.	. Is a periodic review of the investment portfolio made by designated officers?			

FI	XED ASSETS	YES	NO	N/A
Re	ecording			
1.	Does the agency maintain formal (written) capitalization policies to govern which types of charges are capitalized as fixed assets?			
2.	Are the methods for selecting useful lives and depreciation policy clearly defined and approved by designated personnel?			
3.	Are there controls in place to ensure that only appropriate charges are capitalized as fixed assets?			
4.	Does the agency have a well-defined policy for distinguishing between capital expenditures and repairs and maintenance expenditures?			
5.	Are detailed fixed assets subsidiary records maintained, and do they include:			
	a. Asset description?			
	b. Identification number?			
	c. Cost?			
	d. Acquisition date?			
	e. Depreciation method?			
	f. Related depreciation?			
	g. Useful life?			
	h. Percentage of federal participation?			
	i. Grant number under which it was procured?			
	j. Location?			
	k. Who holds title?			
	1. Current condition of asset?			
6.	Are the detailed records reconciled regularly to the general ledger control accounts throughout the year?			

<u>FI</u>	IXED ASSETS		NO	N/A
7.	Are acquisitions of property authorized by designated personnel for:			
	a. All capital expenditures?			
	b. Major renovations?			
	c. Major repair jobs?			
Fi.	xed Assets Inventory			
1.	Are all fixed assets physically inspected periodically and compared to detail records, at least every two years as required by FTA?			
2.	Are written instructions and procedures followed for fixed assets inventory counts and is compliance with them checked?			
3.	Are fixed assets inventory counts supervised by qualified persons following the written instructions and procedures?			
4.	Does the fixed assets inventory process ensure that the current condition of assets is noted and updated in the fixed assets records?			
5.	Are fixed assets/property custodians independent of the fixed assets accounting function?			
6.	Are all fixed assets adjustments documented, and do they require management approval?			
Fi.	xed Assets Disposals			
1.	Does the agency have formal (written) procedures to govern the disposal of fixed assets and property?			
2.	Does the retirement or sale of property require the review and approval of designated personnel?			
3.	Are procedures in place to ensure that the rationale for disposal is documented and approved for all fixed assets disposed?			
4.	Are procedures in place to ensure that property physically retired is properly removed from the accounting records and that the proceeds from sale, if any, are properly accounted for?			

FI	FIXED ASSETS			N/A
5.	Are there controls in place to ensure that FTA receives its share of any proceeds upon disposal of grant-funded assets, if required?			
Fi.	xed Assets Safeguards			
1.	Are physical safeguards (e.g., alarms, guards, restricted access) over property in place?			
2.	Is all property adequately insured and is insurance coverage reviewed periodically?			
3.	Are depreciable lives reviewed periodically by management and compared to actual experience for adequacy?			
4.	Are procedures in place to identify possible impairments in the carrying amounts of long-lived assets?			
Fixed Assets Maintenance				
1.	Does the agency have formal (written) maintenance procedures for maintaining grant-funded rolling stock assets in serviceable condition?			
2.	Does the agency have controls in place to ensure that fixed assets preventive maintenance schedules are adhered to?			
3.	Do the agency's controls ensure that standards for timely preventive maintenance are achieved more than 80 percent of the time for all scheduled maintenance?			
4.	Is senior management kept informed on the status of the performance of preventive maintenance on rolling stock assets?			
Sp	are Parts			
1.	Are spare parts inventories adequately safeguarded and insured?			
2.	Are employees who are responsible for custody of spare parts inventories independent of the inventory recording and accounting functions?			
3.	Are receiving reports for all incoming parts and materials prepared for the accounting/finance department matched with purchase orders and invoices?			

FL	IXED ASSETS		NO	N/A
4.	Are perpetual inventory records maintained for supplies and spare parts?			
5.	Do the perpetual records show:			
	a. Quantities?			
	b. Unit costs?			
	c. Aggregate dollar values?			
6.	Are the perpetual records kept by employees who have no access to the spare parts inventory?			
7.	Are perpetual inventory records checked regularly by cycle counts? If yes:			
	a. Are all classes of inventory subjected to cycle counts?			
	b. Are significant differences between cycle counts and perpetual records investigated and reconciled?			
	c. Are inventory adjustments documented and do they require management approval?			
8.	Are full inventories of spare parts taken at the end of the fiscal year?			
9.	Are significant differences between physical counts and perpetual records investigated promptly?			
10.	Are perpetual records reconciled periodically to the controlling accounts in the general ledger?			
11.	Are perpetual records adjusted to physical inventory counts at least once a year, and are adjustments to the inventory records approved by a responsible employee?			
12.	Are written instructions and procedures followed for inventory counts, and is compliance with them checked?			
13.	Are inventory counts supervised by qualified persons following the written instructions and procedures?			

FI	XED ASSETS		NO	N/A
14	. Are priced inventory sheets numerically controlled and verified as to:			
	a. Quantities?			
	b. Unit cost?			
	c. Extensions and footings?			
15	. Are costs, extensions, and footings of the inventory listings verified be a second person?	y 		
16	Are spare parts inventory adjustments documented, and do they require management approval?			
PR	ROCUREMENT	YES	NO	N/A
As	ssessment of Need			
1.	Does the agency have a written Procurement Manual? If yes:			
	a. Does it conform to FTA's procurement regulations?			
2.	Does the agency have a procurement department? If yes:			
	a. Is it independent of the accounting/finance and receiving departments?			
3.	Are departments other than the agency's procurement department authorized to make purchases? If yes:			
	a. Are there procedures in place to control these purchases?			
	b. Are dollar limits established for these departments?			
	c. Are purchases made by other departments reviewed by the procurement department for appropriateness, availability of funds and to avoid purchase of unnecessary or duplicative items?	·		
4.	Are proposed procurements made only after the respective department heads sign off on purchase requisitions?	it		

PROCUREMENT

Procurement Structure

1. Regarding the type of procurement arrangement to be structured (i.e.,

Pr	оси	rement Structure		
1.	sm	garding the type of procurement arrangement to be structured (i.e., all purchase, sealed bid, competitive proposaleither fixed price or st-reimbursement, non-competitive/sole source):		
	a.	Is the decision on procurement type based on predetermined dollar limits?	 	
	b.	Is the procurement structure approved by senior management levels or by the board of directors?	 	
2.	ens	e small purchases periodically monitored for appropriateness (i.e., to sure that multiple small purchases are not being made to circumvent requirements/procedures for large purchases)?	 	
3.	Ar	e purchases by credit card authorized and allowed? If yes:	 	
	a.	Are there procedures/limitations in place to regulate their use?	 	
	b.	Are monthly statements reviewed for appropriateness of purchases, by either the procurement department or by other agency officials?	 	
4.		e items purchased only after competitive bids are obtained? If yes, competitive bids obtained for:	 	
	a.	All purchases, specific types of purchases, or purchases over predetermined dollar limits?	 	
5.		e purchase orders sent to vendors for all purchases, specific types of rchases, or purchases over predetermined dollar limits?	 	
6.	Do	purchase orders specify:		
	a.	Description of items?	 	
	b.	Quantity?	 	
	c.	Price?	 	
	d.	Terms?	 	
	e.	Delivery requirements and dates?		

PR	COCUREMENT	YES	NO	N/A
7.	Is a list of open purchase orders maintained and reviewed periodically?			
8.	Are purchase order forms pre-numbered?			
9.	Is the sequence of purchase order numbers accounted for periodically?			
10	Does the agency's procurement or requisitioning department develop independent cost estimates before receiving bids or proposals?			
Ve	ndor Qualification			
1.	Does the agency maintain an approved vendors list? If yes:			
	a. Is the approved vendors list kept current?			
	b. Does the approved vendors list include pre-qualified vendors for certain types of procurements?			
2.	Are assessments made of a vendor's ability to successfully perform before a contract is awarded? If yes, does this assessment consider:			
	a. The vendor's technical capability to perform?			
	b. The vendor's financial position and financial capacity?			
	c. The vendor's past performance?			
Ve	ndor Selection			
1.	Are there formal (written) selection procedures used for each type of procurement, including procedures for evaluating the technical aspects of a procurement?			
2.	Do the agency's procurement procedures specify the documentation that is required to be maintained for each procurement?			
3.	Are the decision criteria and results documented and retained?			
Ci	vil Rights			
1.	Do the agency's procurement procedures ensure that minority firms and women-owned business enterprises are used whenever possible?			

PF	<u>PROCUREMENT</u>			N/A
2.	If Disadvantaged Business Enterprises (DBEs) must be utilized or invited to bid, are there procedures in place to identify potential DBE vendors and ensure appropriate communication of solicitations to DBEs?			
Ca	ontract Modifications			
1.	Are there procedures in place to ensure that modifications requested by a vendor are not already in the original scope of work?			
2.	Are requirements analyses prepared by the user departments and approved by the procurement department before the contract modifications are issued?			
3.	Is there a process in place for developing independent cost estimates in connection with cost modifications?			
4.	Are there procedures in place to ensure that the vendor is qualified to perform the additional services?			
Di	spute Resolution			
1.	Are there documented (written) policies for handling contract disputes with vendors?			
2.	Do the dispute resolution policies specify under which circumstances or at what point FTA should be informed of a contract dispute with a vendor?			
Ca	onflicts of Interest			
1.	Does the agency have written standards of conduct in place that define real or perceived conflicts of interest relative to the performance of the agency's representatives involved in the award or administration of contracts? If yes:			
	a. Are the agency's contracting representatives made aware of these standards?			
	b. Are the standards enforced?			

<u>A(</u>	CCOUNTS PAYABLE	YES	NO	N/A
1.	Does the agency have detailed written procedures for processing accounts payable transactions? If yes:			
	a. Are the procedures current and accessible to all staff involved in the processing of accounts payable transactions?			
2.	Do the agency's accounts payable processing procedures describe the criteria for deciding what to pay and when to pay certain invoices?			
3.	Is a log maintained of all goods and/or services received?			
4.	Does the receiving department prepare receiving reports to verify receipt of goods and/or services received? If yes, are receiving reports:			
	a. Prepared for all items?			
	b. Pre-numbered?			
5.	At the time that goods and/or services are received, and before acceptance, does someone independent of the procurement department check the terms of the purchase order as to:			
	a. Description?			
	b. Quantities?			
	c. Condition?			
	d. Price?			
6.	Are copies of receiving reports:			
	a. Furnished to the accounting/finance department?			
	b. Furnished to the procurement department?			
	c. Filed in the receiving department?			
7.	Are receipts under blanket purchase orders monitored, and are quantities exceeding authorized totals returned to vendor?			
8.	Are procedures in place for the proper accounting for partial deliveries of purchase orders?			

<u>A(</u>	CCOUNTS PAYABLE	YES	NO	N/A
9.	Are procurement and receiving functions separate from invoice processing, accounts payable, and general ledger functions?			
10.	Are vendors' invoices, receiving reports, and purchase orders matched (i.e., three-way match) before invoices are processed?			
11.	Are open (i.e., unmatched) receiving reports recorded as a liability at month-end?			
12.	Are all vendors instructed to mail their invoices to the same name/department and address?			
13.	Are vendor invoices checked as to:			
	a. Prices?			
	b. Extensions and footings?			
	c. Freight charges or allowances?			
	d. Credit terms?			
14.	Are controls in place to ensure that all available vendor discounts are taken?			
15.	Are purchases recorded in a purchase register or voucher register before being processed through cash disbursements?			
16.	Does a responsible employee assign the appropriate general ledger account distribution to which the invoices are to be posted? If yes:			
	a. Is the general ledger account coding reviewed and approved prior to posting?			
17.	Are there procedures in place to ensure that costs coded to FTA grants/projects are reasonable, allowable, and allocable? If yes:			
	a. Is the coding to FTA grants/projects reviewed and approved prior to posting?			
18.	Are there procedures in place to ensure that invoices have been processed before payment and to prevent duplicate payment (e.g., a block stamp)?			

<u>A(</u>	CCOUNTS PAYABLE	YES	NO	N/A
19.	Does a responsible official approve invoices for payment?			
20.	Are there procedures in place to avoid the risk that a project manager or department head could misplace an invoice before approving it and submitting it to accounts payable?			
21.	Are open (i.e., unmatched) receiving reports, purchase orders, and vendors' invoices periodically reviewed and investigated for proper recording?			
22.	Is the accounts payable ledger or voucher register reconciled monthly to the general ledger control accounts?			
23.	Are statements from vendors regularly reviewed and reconciled against recorded liabilities?			
24.	Do adjustments to accounts payable (e.g., write-off of Debit balances) require the approval of a designated official?			
<u>PAYROLL</u>		YES	NO	N/A
1.	Are personnel/human resources records maintained independent of the payroll processing and timekeeping functions?			
1.	•			
2.	payroll processing and timekeeping functions?  Are there specific controls and procedures (written) established to govern the payroll set-up and modification process to ensure that only			
2.	payroll processing and timekeeping functions?  Are there specific controls and procedures (written) established to govern the payroll set-up and modification process to ensure that only (and all) authorized employees are paid, at the correct wage rates?			
<ol> <li>3.</li> </ol>	payroll processing and timekeeping functions?  Are there specific controls and procedures (written) established to govern the payroll set-up and modification process to ensure that only (and all) authorized employees are paid, at the correct wage rates?  Are procedures accessible to all staff involved in payroll processing?			

<u>PAYROLL</u>			NO	N/A
7.	Are salary and wage rates authorized in writing by a designated official and/or fixed by union contract?			
8.	Are signed authorizations maintained on file for employees whose wages are subject to special deductions?			
9.	Are bonuses, commissions, and overtime:			
	a. Approved in advance?			
	b. Reviewed for compliance with agency policy?			
10.	Are sick leave, vacations, and holidays reviewed for compliance with agency policy?			
11.	Are appropriate forms (e.g., W-4) completed and signed by employees to authorize payroll deductions and withholding exemptions?			
12.	Are the payroll accounting records periodically checked against the personnel records for terminated employees, fictitious employees, etc.?			
13.	Does the agency use a time clock and/or timesheets to capture payroll hours for:			
	a. General office workers?			
	b. Operations/maintenance workers?			
14.	If the agency uses a time clock, are time cards:			
	a. Punched by the employee in the presence of a designated supervisor?			
	b. Signed by a supervisor at the end of the payroll period?			
15.	If the agency uses time sheets for certain employees, are time sheets:			
	a. Signed by the employee at the end of the payroll period?			
	b. Signed by a supervisor at the end of the payroll period?			
16.	Are time cards and time sheets reviewed and compared with:			

PA	YR	<u>ROLL</u>	YES	NO	N/A
	a.	The payroll distribution report?			
	b.	Production schedules (route schedules, dispatch reports, etc.)?			
17		fore payroll is disbursed, are payroll registers reviewed and proved for:			
	a.	Names of employees?			
	b.	Hours worked?			
	c.	Wage rates?			
	d.	Deductions?			
	e.	Agreement with payroll checks?			
	f.	Unusual items?			
18	. Ar	e employees paid out of a separate payroll bank account?			
19	. Ar	e payroll checks pre-numbered and issued in numerical sequence?			
20	. Is a	access to the following restricted?			
	a.	Unissued payroll checks?			
	b.	Signature plate?			
21	. Ar	e checks drawn and signed by designated officials who do not:			
	a.	Prepare the payroll?			
	b.	Have access to the accounting records?			
	c.	Have custody of cash funds?			
22	. Ar	e payroll checks distributed by someone other than the:			
	a.	Department heads or supervisors that approve time cards or time sheets?			
	b.	Persons who prepare the payroll?			

PAYROLL	YES	NO	N/A
23. Is the distribution of the payroll rotated periodically to different employees without prior notice?			
24. Is the payroll bank account reconciled by a designated employee wh	10:		
a. Is not involved in preparing the payroll?			
b. Does not sign the checks?			
c. Does not handle the check distributions?			
25. Do payroll bank account reconciliation procedures include:			
a. Comparing the paid checks to the payroll?			
b. Scrutinizing canceled check endorsements?			
26. Are the payroll registers reconciled regularly to the general ledger control accounts?			
27. Is a liability account set up for all wages that have remained unclair for a certain period of time? If yes:	med		
a. Have these wages been re-deposited in a special bank account?			
b. Is identification required to be presented at the time of their subsequent distribution?			
28. Are distributions of hours (direct and indirect) to activity or departments reviewed and approved by supervisory personnel?			
29. Are actual payroll amounts reviewed and compared to budgeted amounts, and are variances analyzed regularly?			
30. Are detailed records maintained of the agency's liability for vacatio pay and sick pay? If yes:	n 		
a. Are they reconciled to the general ledger accounts periodically?			
31. Are payroll accruals approved by a responsible official?			

PA	<u>PAYROLL</u>			NO	N/A
Force Account Labor					
1.		bes the agency charge its own employee labor directly to capital ojects funded by grants? If yes:			
	a.	Does the agency have a force account plan that has been approved by FTA, if applicable?			
	b.	Does the agency have formal procedures (written) for determining which labor hours are to be capitalized and charged to FTA grants?			
	c.	Are authorizations and approvals needed or obtained prior to when the work is done?			
	d.	Is the timing of force account labor controlled by a capital projects schedule, rather than allowing project managers (foremen) or agency management the latitude over when this is done?			
	e.	Are there procedures in place to ensure that force account labor is not both expensed and capitalized?			
	f.	Are there controls in place to govern the utilization of overtime labor on capital projects?			
<u>O'</u>	VEF	RHEAD	YES	NO	N/A
Co	st A	Illocation Plan			
1.	bee	bes the agency have an indirect Cost Allocation Plan (CAP) that has en approved by FTA, or other cognizant federal agency, if plicable? If yes:			
	a.	Does the agency have formal (written) procedures in place to ensure that its CAP is prepared in accordance with OMB Circular A-87, <i>Cost Principles for State, Local and Indian Tribal Governments</i> ?			
	b.	Do the procedures for developing the CAP ensure that indirect costs are allocated on an appropriate basis (i.e., direct labor, total direct costs, etc.)?			

<u>O/</u>	<u>OVERHEAD</u>			NO	N/A
	c.	Does the agency require management approvals of the CAP prior to application of the resultant rates, or prior to submission to FTA for approval, if required?			
	d.	Are there controls in place to ensure that the CAP rates are correctly applied to the appropriate costs?			
<b>O</b> v	erh	ead Labor Costs			
1.		bes the agency have a method for determining which overhead labor urs are to capitalized?			
2.		there a review and authorization process to ensure that capitalization indirect labor is properly charged within FTA parameters?			
Inc	lire	ct Costs			
1.	caj	e there procedures in place for charging other indirect costs to pital projects, such as percentages of certain overhead support actions (e.g., legal, IT/EDP, etc.)?			
2.		there a review and authorization process whereby the types of arges are identified and approved?			
3.	Do	procedures exist to ensure that indirect costs:			
	a.	Are charged to capital projects on a regular basis (e.g., monthly)?			
	b.	Are correctly calculated?			
	c.	Are reviewed for reasonableness and consistency?			
	d.	Are properly authorized?			
Di	rect	Costs			
1.		e there procedures in place for charging certain direct costs (e.g., oplies, construction equipment, etc.) to capital projects?			
2.	ide	there a review and authorization process whereby the direct costs are entified, verified, approved, and charged to the project accounting stem?			

<u>O</u>	<u>OVERHEAD</u>			N/A
3.	Do procedures exist to ensure that direct costs are:			
	a. Coded or charged to the correct capital projects?			
	b. Correctly accumulated and correct in amount?			
	c. Reviewed for reasonableness?			
	d. Properly authorized?			
BU	UDGET CONTROLS	YES	NO	N/A
0 <sub>l</sub>	perating Budget			
1.	Does the agency have detailed formal (written) procedures for formulating the annual operating budget? If yes:			
	a. Are these procedures current and accessible to all staff involved the budget formulation process?	in		
2.	Is the operating budget prepared in sufficient detail to provide a meaningful tool by which to monitor performance?			
3.	Are senior management approvals and/or board of director approval needed to enact the operating budget?	LS		
4.	Is performance against the operating budget reviewed by responsible individuals throughout the course of the year? If yes:	e		
	a. Is budget performance measured regularly (e.g., monthly, quarterly)?			
	b. Is budget performance measured and reported within a reasonab amount of time after the end of the period?	le		
	c. Are actual expenditures compared with budgeted amounts and variances investigated and explained?			
	d. Are actual expenditures compared with prior year amounts and variances analyzed and explained?			

BU	J <b>D</b> (	GET CONTROLS	YES	NO	N/A
	e.	Is variance analysis performed at a sufficient level of detail by which to adequately monitor operating performance (i.e., at the budget line item level)?			
	f.	Is appropriate documentation maintained as evidence of variance investigation and in support of variance explanations?			
	g.	Are the results of variance analyses provided to senior management?			
Ca	ıpita	al Project/Grant Planning			
1.		te there procedures in place for planning capital projects and for taining grant funding?			
2.		re appropriate departments involved in the capital project/grant anning process (i.e., planning, engineering, customer service, etc.)?			
3.		procedures exist to ensure that the agency's plans as described in Transportation Improvement Plan are being followed?			
4.	ap ap	re there procedures in place to provide assurance that required provals and funding commitments are obtained from FTA and from propriate state/local funding sources before spending commitments e entered into?			
Ca	ıpita	al Budget			
1.		bes the agency have detailed written procedures for formulating the nual capital budget? If yes:			
	a.	Are these procedures current and accessible to all staff involved in the budget formulation process?			
	b.	Is the capital budget formulation process coordinated with the operating budget process?			
	c.	Are appropriate departments involved in the capital budget development process (i.e., planning, engineering, construction, project management, etc.)?			
2.		the capital budget prepared in sufficient detail to provide a caningful tool by which to monitor capital project progress?			

BU	J <b>D</b> (	GET CONTROLS	YES	NO	N/A
3.		e senior management approvals and/or board of director approvals eded to enact the capital budget?			
4.	Is performance against the capital budget reviewed by responsible individuals throughout the course of the year? If yes:				
	a.	Is budget performance measured regularly (e.g., monthly)?			
	b.	Is budget performance measured and reported within a reasonable amount of time after the end of the period?			
	c.	Are actual expenditures compared with budgeted amounts and variances investigated and explained?			
	d.	Is variance analysis performed at a sufficient level of detail by which to adequately monitor progress or performance (i.e., at the budget line item level)?			
	e.	Is appropriate documentation maintained as evidence of variance investigation and in support of variance explanations?			
	f.	Are the results of variance analyses provided to senior management?			
<u>Gl</u>	RAI	NTS MANAGEMENT	YES	NO	N/A
Gı	ant	Records			
1.	fro	bes the agency use a separate grants management system (i.e., apart om the agency's main financial management/general ledger system) track grant activity? If yes:			
	a.	Does this system accumulate both current year grant activity, as well as cumulative (inception-to-date) financial information for each grant held?			
	b.	Does this system track special classifications, if any, of grant expenditures?			
	c.	Does this system track grant financial information by grant budget line item?			

Gl	RANTS MANAGEMENT	YES	NO	N/A
	d. Does this system track milestone information, as well as budget and financial information?			
	e. Is there a process for reconciling grant financial information per this system to the agency's general ledger system?			
	f. Is there a process for reconciling grant financial information per this system to FTA's TEAM system?			
	g. Are reconciliations of the grants management system performed regularly (i.e., monthly, quarterly)?			
2.	Does the agency have a documented process for determining whether grant expenditures are allowable before they are incurred?			
3.	Once incurred, does the agency have procedures in place to ensure that only approved and allowable costs have been charged to grants?	; ——		
4.	Is there a process preventing charges from being posted against grants incorrectly, or for reversing incorrect charges?			
5.	Are there procedures in place to govern the recording of contract change orders in the grants management system?			
6.	For change orders recorded, is historical grant data maintained (i.e., do grant records reflect incremental changes rather than having information be overwritten)?			
7.	Are change orders recorded in the grants management system on a timely basis?			
En	ncumbrances			
1.	Does the agency track major encumbrances of grant balances for project expenses? If yes:			
	a. Does the agency have detailed written procedures to describe the documentation required to establish encumbrances against grants and to control the flow of documentation?			
	b. Is there a review and authorization process to ensure that encumbrance amounts are established against the correct grants and are recorded correctly?			

GRANTS MANAGEMENT				NO	N/A
	c.	Are encumbrance amounts recorded/released/adjusted at the individual grant level by the agency's grants management system?			
	d.	Does the grants management system (or other system that tracks encumbrances) interface with the procurement system?			
Gr	ant	Reporting			
1.	fin	e there formal (written) procedures in place to ensure that quarterly ancial status reports (FSRs) are prepared and submitted to FTA nely (i.e., submitted within 30 days after quarter end)?			
2.		the agency's grants management system used as the source for taining financial information for the FSRs?			
3.		there a documented review and authorization process prior to omission to FTA to ensure that FSRs are complete and accurate?			
4.		there a process for reconciling FSR information for individual grants the general ledger system?			
5.		there a process for reconciling FSR information for individual grants the information tracked by FTA's TEAM system?			
6.	6. Are FSRs prepared on the accrual basis as required by FTA?				
Bu	dge	et Revisions			
1.	bu	e there formal (written) procedures in place to ensure that grant dget revisions are made only when properly authorized and stiffied? Specifically:			
	a.	Do the procedures describe the documentation required to initiate a grant budget revision?			
	b.	Do the procedures describe the process for recording budget revisions in the grants management system and main financial management system?			
	c.	Is there a review and authorization process in place?			
	d.	Are the same departments involved as those included in the capital budget development process?			

<u>Gl</u>	RAI	NTS MANAGEMENT	YES	NO	N/A
2.	co	the there procedures in place to ensure that grant budget revisions are mmunicated to FTA in a timely manner, and approved by FTA, if quired?			
Gr	ant	Close-Out			
1.	Does the agency have formal (written) policies and procedures in place for closing out grants?				
2.	Do	the agency's grant close-out procedures:			
	a.	Specify what documentation should be maintained related to the close-out of a grant?			
	b.	Ensure that grants are closed out and final FSRs are submitted on a timely basis?			
	c.	Ensure that inactive grants with unspent balances are not carried forward beyond when close-out should occur (i.e., when all approved grant project activities are complete)?			
	d.	Ensure that inactive grants with excess balances are not being used for other projects without the advance approval of FTA?			
<u>PF</u>	<u>ROJ</u>	ECT MANAGEMENT	YES	NO	N/A
Pr	ojec	et Accounting			
1.	(i.e	bes the agency use a separate project management/tracking system e., apart from the main financial management/general ledger system) track progress of construction capital projects? If yes:			
	a.	Is the agency's project management system used as the source for obtaining narrative project milestone information for quarterly FSR reporting to FTA?			
	b.	Does this system track project milestone information, as well as budget and financial information?			
	c.	Is there a process for reconciling project costs per the project management system to the agency's general ledger system?			

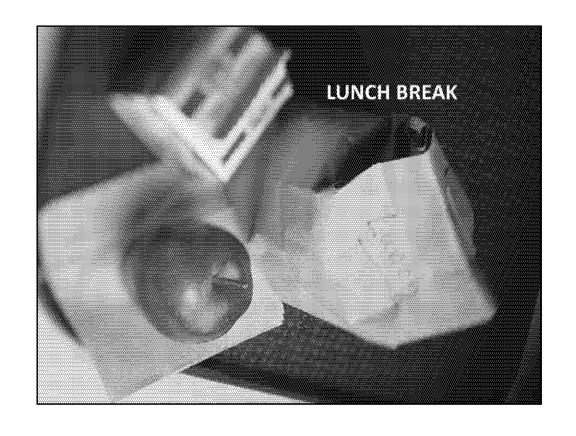
PROJECT MANAGEMENT				NO	N/A
	d.	Is there a process for reconciling project costs per the project management system to the agency's grants management system?			
	e.	Are reconciliations of the project management system performed regularly (e.g., monthly, quarterly)?			
	f.	Are receiving documents, purchase orders (or contracts), and invoices matched before transactions are recorded in the project management system?			
Pro	ojec	t Management			
1.	Do	bes in-house construction require authorized work orders?			
2.		construction-in-progress regularly reviewed for adherence to dgeted amounts?			
3.	tha	engineers and project managers use non-dollar metrics (i.e., other an dollar percentage of completion) to measure the progress of pital construction projects?			
4.	Ar	e project status meetings held on a regular basis?			
5.		e project status reports prepared and reviewed regularly with project magers and senior management?			
6.	an	regular project status meetings and/or project status reports provide effective means for identifying and addressing problem areas or oject crises as they arise?			
7.	Ar	e problem areas dealt with within a reasonable time frame?			
8.		there a process in place to keep FTA informed of problems that uld potentially impact FTA capital project grants?			
9.		a problem requires a contract change, is there a documented process initiation, funding, and review/approval of the change order?			
10.	rev	a contract change order results in the need for a grant budget vision, is there a documented process for preparation, review, and proval of the budget revision request, prior to submission to FTA?			

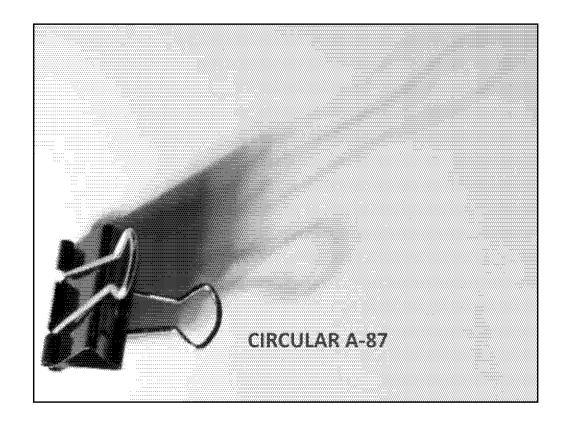
<u>IT</u>	<u>CONTROLS</u>	YES	NO	N/A
1.	Is the IT department independent of all user departments?			
2.	Is there clear segregation of duties between computer programmers and computer operators?			
3.	Are IT personnel prohibited from initiating transactions and making changes to master files?			
4.	Are computer operators required to take annual vacations and are their duties rotated periodically?			
5.	Is access to the data center/computer room restricted to authorized personnel only?			
6.	Are computer programmers prohibited from accessing production programs, job control language, and live data files?			
7.	Are computer operators prohibited from accessing source code and programming documentation?			
8.	Is new or revised program testing on live data files strictly prohibited?			
9.	Are utility programs adequately controlled and their use logged for subsequent management review?			
10.	Are unique and confidential passwords required to access IT systems?			
11.	Are passwords changed at regular intervals and canceled for terminated employees?			
12.	Are there restrictions on the length and type of password that can be chosen?			
13.	Do individuals have access only to those programs or files that are necessary to perform their duties?			
14.	Are there procedures in place for documenting new systems and programs, as well as documenting modifications of existing ones?			
15.	Do system and program development procedures require active involvement by the users, including:			
	a. User involvement in the design and approval of systems?			

<u>IT</u>	<u>CO</u>	<u>NTROLS</u>	YES	NO	N/A
	b.	User review of the completion of various phases of the application?			
	c.	User testing of new programs?			
16.	ano	e system and program modifications subject to appropriate testing, d are test results reviewed and approved by user department and IT nagement?			
17.		e schedules prepared and adhered to for processing of computer plications?			
18.	Ar	e adequate job set-up and execution procedures in place over:			
	a.	Setting up of batch jobs?			
	b.	Loading on-line application systems?			
	c.	Loading system software?			
	d.	Input and output media to be used?			
19.		e there procedures in place for identifying, reporting, and approving erator actions over:			
	a.	Initial loading of system and application software?			
	b.	System failures?			
	c.	Restart and recovery?			
	d.	Emergency situations?			
	e.	Any other unusual situations?			
20.	Ar	e logs used to record operator activities? If yes:			
	a.	Are they reviewed by appropriate personnel?			
21.	Ar	e the agency's application programs compatible with each other?			
22.		e there procedures in place to control logical access to computer plications and data files, to achieve the following:			

T	CC	<u>NTROLS</u>	YES	NO	N/A
	a.	Restricting access to confidential and sensitive data?			
	b.	Reducing the risk of entering unauthorized transactions into processing?			
	c.	Detecting unauthorized changes to programs supporting the financial statements?			
	d.	Controlling programmer access to production programs and live data files?			
	e.	Controlling operator access to source code and individual elements of data files?			
	f.	Limiting access by users to defined programs and data files?			
23.		e there procedures in place to prevent the introduction of viruses I to recover from a virus infection? If yes, do they include:			
	a.	Obtaining only recognized software from reputable sources?			
	b.	Accepting only delivery of software in the manufacturer's sealed package?			
	c.	Using virus protection software to screen for virus infections?			
	d.	Prohibiting the use of unauthorized programs introduced by employees?			
	e.	Prohibiting downloading of untested software from unknown sources?			
24.		e there appropriate procedures for backup and storage of programs data files?			
25.		e critical data files, systems, and program libraries backed up gularly and stored off-site?			
26.	rec	s the agency developed a formal (written) contingency or disaster overy plan to provide alternative processing and continued data vices in the event of an emergency or disaster that results in loss or erruption of the IT function? If yes:			

<u>IT CONTROLS</u>			YES	NO	N/A
	a.	Does the contingency or disaster recovery plan include:			
		i. Documented procedures for system recovery?			
		ii. Designation of conditions for implementing off-site disaster recovery?			
		iii. Procedures for obtaining alternative hardware and software?			
		iv. Listing of all critical applications, programs, system software, and data files?			
		v. Priorities and schedules for information retrieval?			
		vi. Assignment of roles and responsibilities for key employees?			
		vii. Listing of all key contacts and their telephone numbers?			
	b.	Have the roles and responsibilities described in the contingency or disaster recovery plan been communicated to the employees identified as key contacts in the plan?			
	c.	Is the contingency or disaster recovery plan tested periodically to ensure its effectiveness?			
27	all	bes the agency periodically perform an IT risk assessment to identify potential risks and vulnerabilities, as well as to make decisions out which to mitigate through security controls?			
28		there a written security plan that describes the agency's IT security ogram, as well as the policies and procedures that support it?			
29		bes the agency have an IT security awareness program, the purpose which is to inform all users of the established IT security policies?			





### OMB Circular A-87 Federal Cost Principles

- A set of established accounting principles to be used in determining the allowable costs applicable to federal grants, subgrants, and cost type contracts awarded under federal grants.
- Implemented thru FTA Circular 5010.1D, Chapter VI,
   Parts 5 and 6.

# OMB Circular A-87 Federal Cost Principles A-87 is one of 5 sets of Federal cost principles: \* A-87 - State & Local Gov't (FAR 31.6) \* A-21 – Universities (FAR 31.3) A-122 – Non-profits (FAR 31.7) FAR – Federal Acquisition Regulations (48 CFR 31.2) CAS – Cost Accounting Standards – Only applies to contracts>\$500,000

#### OMB Circular A-87 What It Does

- Sets basic policies/procedures for identifying program costs
- \* Identifies allowable and unallowable costs
- Specifies allocation criteria
- Stipulates cost allocation plan requirements
- Cites documentation requirements
- Mandates cognizant agency approval/appeal concept
- Brings rationality to the cost determination and approval process

### OMB Circular A-87 What It Does Not Do

- Supersede limitations imposed by law or regulation
- Dictate extent of federal funding or extent of matching required
- Dictate organizational form or management techniques needed for program administration
- Relieve state and local governments of stewardship responsibilities for federal funds

Circular Stru Attachment A:	Purpose and Scope
Attachment B:	Selected Items of Cost
Attachment C:	State/Local-Central Service Cost Allocation Plans
Attachment D:	Public Assistance CAP
Attachment E:	Indirect Cost Rate Proposals

### OMB Circular A-87 – Attachment A Objectives Purpose: cost determination, not level of funding Designed to provide that Fed. Awards bear fair share of costs \* Profit provision outside scope Policy guides Fundamental premise: state/local govs responsible for administration of Federal Awards Application \* All Fed. Agencies Sub-awards Guide for FP cost based contracts. · CAS Definitions awarding agency, approval, contracts, cog. Agency, cost, state/local gov.

OMB Circular A-87	– Attachment A
Basic guidelines:	
■ Allowable  ■ Reasonable	
* Allocable	

### OMB Circular A-87 – Attachment A Allowable: necessary & reasonable allocable not prohibited under state/local laws/reg. Conform w/ Fed. limitations/exclusions apply uniformly to Fed. & non-Fed. Activities \* consistent cost treatment conform w/GAAP adequately documented not claimed on other Fed. Awards as cost or cost sharing

# OMB Circular A-87 – Attachment A Reasonable: Prudent person factors ordinary & reasonable for activity sound business practices market prices significant deviation from established practices

# OMB Circular A-87 – Attachment A Allocable: assessed to activities based on relative benefit \* assessed to all activities regardless of fund sources

### OMB Circular A-87 - Attachment A Composition of Costs \*Total costs = direct costs + indirect costs - applicable Classification: no universal rule; but must be consistent # Direct Costs \* Identifiable specifically with a particular cost objective, i.e., project or award or primary function Indirect Costs Costs of general support activities that benefit more than one cost objective Not readily assignable w/o disproportionate effort

# OMB Circular A-87 **Examples of Direct Costs** Cost incurred in performing a function/project/grant: Bus/Rail operations Planning Customer relations and services Land acquisition/Real estate Construction Project Administration

### -OMB Circular A-87 **Examples of Indirect Costs** Administrative support activities Director's office and staff Human resources Accounting/Budgeting Purchasing General facilities management Internal audit General services \* Risk management

## OMB Circular A-87 **Unallowable Costs** \* Alcoholic Beverages Bad Debts (unless provided for in federal program award regulations) \* Contingencies Contributions and Donations Entertainment Fines and Penalties

# OMB Circular A-87 Unallowable Costs Defense of civil or criminal fraud or proceedings commenced by the U.S. or a State Fundraising/investment management costs, except for costs associated with pension plans General Government Lobbying

### OMB Circular A-87 Idle Facilities/Idle Capacity

Unallowable except when:

- Necessary to meet fluctuations in workload
- Necessary when acquired, but idle due to changes in program requirements (allowable for a reasonable period of time, usually not to exceed one year)
- Normal cost of doing business and a factor in the normal fluctuations of usage

### OMB Circular A-87 Interest Unallowable, except: Financing costs of building acquisition, construction or fabrication, reconstruction or remodeling Financing costs of equipment Conditions: Bona fide third party external to governmental unit Assets used in support of federal awards \* Earnings on debt service offset Negotiate allowable interest on federal portion

# OMB Circular A-87 Advertising and Public Relations Advertising • Unallowable unless incurred for: recruitment of personnel, procurement of goods, disposal of surplus materials and meeting the requirements of the federal award

### OMB Circular A-87 Advertising and Public Relations

Public Relations unallowable except when:

- Required by the federal award, and then only as direct cost
- Incurred to communicate to the public and press about specific activities or accomplishments that result from federal award
- Communicating with the news media regarding matters of public concern

### OMB Circular A-87 Audit Costs

- Costs of audits required by OMB A-133 are allowable as direct or indirect costs.
- Other audit costs are allowable if included in a cost allocation plan or indirect cost proposal, or if specifically approved by the awarding agency as a direct cost to an award.
- The cost of agreed-upon procedures engagements to monitor subrecipients who are exempted from A-133 are generally allowable, subject to the conditions listed in A-133, section 230 (b)(2).

# -OMB Circular A-87 Compensation Documentation Leave Retirement Plans/Pensions, Post Retirement Health Benefits Donated Services Severance Pay

### OMB Circular A-87 Depreciation/Use Allowance

- May not be used in combination for a single class of fixed assets
- If use allowance used, should not exceed 2% of acquisition cost for buildings and improvements and 6 2/3% of acquisition cost for equipment
- Depreciation method shall not change unless approved by cognizant agency
- Must be supported by property records

<u> </u>	-	-	

### OMB Circular A-87 Maintenance

- Unless prohibited by law, the cost of necessary maintenance, normal repairs and upkeep are allowable to the extent they:
  - Keep property in efficient operating condition
  - Do not add to the permanent value of property or appreciably prolong its life
  - Are not otherwise included in rental or other charges for space

### OMB Circular A-87 Memberships Allowable: Business, technical, and professional organizations Subscriptions to business, technical and professional periodicals Costs of meetings and conferences where technical information is disseminated Memberships in civic and community, social organizations (direct cost with approval)

# -OMB Circular A-87 Other Allowable Costs \* ADP Systems Development/Testing Employee Morale/Health/Welfare \* Gains/losses on disposition of property Pre-award costs Proposal preparation costs Self-insurance Taxes Travel \* Working capital reserves

# Circular A-87 Summary Background Cost principles Definitions

# OMB CIRCULAR A-87 (REVISED 05/10/04)

CIRCULAR NO. A-87

Revised

#### TO THE HEADS OF EXECUTIVE DEPARTMENTS AND ESTABLISHMENTS

SUBJECT: Cost Principles for State, Local, and Indian Tribal Governments

- 1. <u>Purpose</u>. This Circular establishes principles and standards for determining costs for Federal awards carried out through grants, cost reimbursement contracts, and other agreements with State and local governments and federally-recognized Indian tribal governments (governmental units).
- 2. <u>Authority</u>. This Circular is issued under the authority of the Budget and Accounting Act of 1921, as amended; the Budget and Accounting Procedures Act of 1950, as amended; the Chief Financial Officers Act of 1990; Reorganization Plan No. 2 of 1970; and Executive Order No. 11541 ("Prescribing the Duties of the Office of Management and Budget and the Domestic Policy Council in the Executive Office of the President").
- 3. <u>Background</u>. As part of the governmentwide grant streamlining effort under P.L. 106-107, *Federal Financial Award Management Improvement Act of 1999*, OMB led an interagency workgroup to simplify and make consistent, to the extent feasible, the various rules used to award Federal grants. An interagency task force was established in 2001 to review existing cost principles for Federal awards to State, local, and Indian tribal governments; Colleges and Universities; and Non-Profit organizations. The task force studied Selected Items of Cost in each of the three cost principles to determine which items of costs could be stated consistently and/or more clearly. A proposed revised Circular reflecting the results of those efforts was issued on August 12, 2002 at 67 FR 52558. Extensive comments on the proposed revisions, discussions with interest groups, and related developments were considered in developing this revision.
- 4. <u>Rescissions</u>. This Circular rescinds and supersedes Circular A-87, as amended, issued May 4, 1995.
- 5. <u>Policy</u>. This Circular establishes principles and standards to provide a uniform approach for determining costs and to promote effective program delivery, efficiency, and better relationships between governmental units and the Federal Government. The principles are for determining allowable costs only. They are not intended to identify the circumstances or to dictate the extent of Federal and governmental unit participation in the financing of a particular Federal award. Provision for profit or other increment above cost is outside the scope of this Circular.
- 6. <u>Definitions</u>. Definitions of key terms used in this Circular are contained in Attachment A, Section B.
- 7. Required Action. Agencies responsible for administering programs that involve cost

reimbursement contracts, grants, and other agreements with governmental units shall issue regulations to implement the provisions of this Circular and its Attachments.

- 8. <u>OMB Responsibilities</u>. The Office of Management and Budget (OMB) will review agency regulations and implementation of this Circular, and will provide policy interpretations and assistance to insure effective and efficient implementation. Any exceptions will be subject to approval by OMB. Exceptions will only be made in particular cases where adequate justification is presented.
- 9. <u>Information Contact</u>. Further information concerning this Circular may be obtained by contacting the Office of Federal Financial Management, Financial Standards and Reporting Branch, Office of Management and Budget, Washington, DC 20503, telephone 202-395-3993.
- 10. <u>Policy Review Date</u>. OMB Circular A-87 will have a policy review three years from the date of issuance.
- 11. Effective Date. This Circular is effective as follows:
  - Except as otherwise provided herein, these rules are effective June 9, 2004.

# OMB CIRCULAR NO. A-87

#### COST PRINCIPLES FOR STATE, LOCAL AND INDIAN TRIBAL GOVERNMENTS

#### TABLE OF CONTENTS

Attachment A - General Principles for Determining Allowable Costs

Attachment B - Selected Items of Cost

Attachment C - State/Local-Wide Central Service Cost Allocation Plans

Attachment D - Public Assistance Cost Allocation Plans

Attachment E - State and Local Indirect Cost Rate Proposals

ATTACHMENT A

Circular No. A-87

#### GENERAL PRINCIPLES FOR DETERMININGALLOWABLE COSTS

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- A. Purpose and Scope
- 1. Objectives. This Attachment establishes principles for determining the allowable costs incurred by State, local, and federally-recognized Indian tribal governments (governmental units) under grants, cost reimbursement contracts, and other agreements with the Federal Government (collectively referred to in this Circular as "Federal awards"). The principles are for the purpose of cost determination and are not intended to identify the circumstances or dictate the extent of Federal or governmental unit participation in the financing of a particular program or project. The principles are designed to provide that Federal awards bear their fair share of cost recognized under these principles except where restricted or prohibited by law. Provision for profit or other increment above cost is outside the scope of this Circular.
- 2. Policy guides.
- a. The application of these principles is based on the fundamental premises that:

- (1) Governmental units are responsible for the efficient and effective administration of Federal awards through the application of sound management practices.
- (2) Governmental units assume responsibility for administering Federal funds in a manner consistent with underlying agreements, program objectives, and the terms and conditions of the Federal award.
- (3) Each governmental unit, in recognition of its own unique combination of staff, facilities, and experience, will have the primary responsibility for employing whatever form of organization and management techniques may be necessary to assure proper and efficient administration of Federal awards.
- b. Federal agencies should work with States or localities which wish to test alternative mechanisms for paying costs for administering Federal programs. The Office of Management and Budget (OMB) encourages Federal agencies to test fee-for-service alternatives as a replacement for current cost-reimbursement payment methods in response to the National Performance Review's (NPR) recommendation. The NPR recommended the fee-for-service approach to reduce the burden associated with maintaining systems for charging administrative costs to Federal programs and preparing and approving cost allocation plans. This approach should also increase incentives for administrative efficiencies and improve outcomes.

# 3. Application.

- a. These principles will be applied by all Federal agencies in determining costs incurred by governmental units under Federal awards (including subawards) except those with (1) publicly-financed educational institutions subject to OMB Circular A-21, "Cost Principles for Educational Institutions," and (2) programs administered by publicly-owned hospitals and other providers of medical care that are subject to requirements promulgated by the sponsoring Federal agencies. However, this Circular does apply to all central service and department/agency costs that are allocated or billed to those educational institutions, hospitals, and other providers of medical care or services by other State and local government departments and agencies.
- b. All subawards are subject to those Federal cost principles applicable to the particular organization concerned. Thus, if a subaward is to a governmental unit (other than a college, university or hospital), this Circular shall apply; if a subaward is to a commercial organization, the cost principles applicable to commercial organizations shall apply; if a subaward is to a college or university, Circular A-21 shall apply; if a subaward is to a hospital, the cost principles used by the Federal awarding agency for awards to hospitals shall apply, subject to the provisions of subsection A.3.a. of this Attachment; if a subaward is to some other non-profit organization, Circular A-122, "Cost Principles for Non-Profit Organizations," shall apply.
- c. These principles shall be used as a guide in the pricing of fixed price arrangements where costs are used in determining the appropriate price.
- d. Where a Federal contract awarded to a governmental unit incorporates a Cost Accounting Standards (CAS) clause, the requirements of that clause shall apply. In such cases, the

governmental unit and the cognizant Federal agency shall establish an appropriate advance agreement on how the governmental unit will comply with applicable CAS requirements when estimating, accumulating and reporting costs under CAS-covered contracts. The agreement shall indicate that OMB Circular A-87 requirements will be applied to other Federal awards. In all cases, only one set of records needs to be maintained by the governmental unit.

# e. Conditional exemptions.

- (1) 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.
- (2) 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.
- (3) 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. Definitions

- 1. "Approval or authorization of the awarding or cognizant Federal agency" means documentation evidencing consent prior to incurring a specific cost. If such costs are specifically identified in a Federal award document, approval of the document constitutes approval of the costs. If the costs are covered by a State/local-wide cost allocation plan or an indirect cost proposal, approval of the plan constitutes the approval.
- 2. "Award" means grants, cost reimbursement contracts and other agreements between a State,

local and Indian tribal government and the Federal Government.

- 3. "Awarding agency" means (a) with respect to a grant, cooperative agreement, or cost reimbursement contract, the Federal agency, and (b) with respect to a subaward, the party that awarded the subaward.
- 4. "Central service cost allocation plan" means the documentation identifying, accumulating, and allocating or developing billing rates based on the allowable costs of services provided by a governmental unit on a centralized basis to its departments and agencies. The costs of these services may be allocated or billed to users.
- 5. "Claim" means a written demand or written assertion by the governmental unit or grantor seeking, as a matter of right, the payment of money in a sum certain, the adjustment or interpretation of award terms, or other relief arising under or relating to the award. A voucher, invoice or other routine request for payment that is not a dispute when submitted is not a claim. Appeals, such as those filed by a governmental unit in response to questioned audit costs, are not considered claims until a final management decision is made by the Federal awarding agency.
- 6. "Cognizant agency" means the Federal agency responsible for reviewing, negotiating, and approving cost allocation plans or indirect cost proposals developed under this Circular on behalf of all Federal agencies. OMB publishes a listing of cognizant agencies.
- 7. "Common Rule" means the "Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments; Final Rule" originally issued at 53 FR 8034-8103 (March 11, 1988). Other common rules will be referred to by their specific titles.
- 8. "Contract" means a mutually binding legal relationship obligating the seller to furnish the supplies or services (including construction) and the buyer to pay for them. It includes all types of commitments that obligate the government to an expenditure of appropriated funds and that, except as otherwise authorized, are in writing. In addition to bilateral instruments, contracts include (but are not limited to): awards and notices of awards; job orders or task orders issued under basic ordering agreements; letter contracts; orders, such as purchase orders, under which the contract becomes effective by written acceptance or performance; and, bilateral contract modifications. Contracts do not include grants and cooperative agreements covered by 31 U.S.C. 6301 et seq.
- 9. "Cost" means an amount as determined on a cash, accrual, or other basis acceptable to the Federal awarding or cognizant agency. It does not include transfers to a general or similar fund.
- 10. "Cost allocation plan" means central service cost allocation plan, public assistance cost allocation plan, and indirect cost rate proposal. Each of these terms are further defined in this section.
- 11. "Cost objective" means a function, organizational subdivision, contract, grant, or other activity for which cost data are needed and for which costs are incurred.

- 12. "Federally recognized Indian tribal government" means the governing body or a governmental agency of any Indian tribe, band, nation, or other organized group or community (including any native village as defined in Section 3 of the Alaska Native Claims Settlement Act, 85 Stat. 688) certified by the Secretary of the Interior as eligible for the special programs and services provided through the Bureau of Indian Affairs.
- 13. "Governmental unit" means the entire State, local, or federally-recognized Indian tribal government, including any component thereof. Components of governmental units may function independently of the governmental unit in accordance with the term of the award.
- 14. "Grantee department or agency" means the component of a State, local, or federally-recognized Indian tribal government which is responsible for the performance or administration of all or some part of a Federal award.
- 15. "Indirect cost rate proposal" means the documentation prepared by a governmental unit or component thereof to substantiate its request for the establishment of an indirect cost rate as described in Attachment E of this Circular.
- 16. "Local government" means a county, municipality, city, town, township, local public authority, school district, special district, intrastate district, council of governments (whether or not incorporated as a non-profit corporation under State law), any other regional or interstate government entity, or any agency or instrumentality of a local government.
- 17. "Public assistance cost allocation plan" means a narrative description of the procedures that will be used in identifying, measuring and allocating all administrative costs to all of the programs administered or supervised by State public assistance agencies as described in Attachment D of this Circular.
- 18. "State" means any of the several States of the United States, the District of Columbia, the Commonwealth of Puerto Rico, any territory or possession of the United States, or any agency or instrumentality of a State exclusive of local governments.

# C. Basic Guidelines

- 1. Factors affecting allowability of costs. To be allowable under Federal awards, costs must meet the following general criteria:
- a. Be necessary and reasonable for proper and efficient performance and administration of Federal awards.
- b. Be allocable to Federal awards under the provisions of this Circular.
- c. Be authorized or not prohibited under State or local laws or regulations.
- d. Conform to any limitations or exclusions set forth in these principles, Federal laws, terms and conditions of the Federal award, or other governing regulations as to types or amounts of cost items.

- e. Be consistent with policies, regulations, and procedures that apply uniformly to both Federal awards and other activities of the governmental unit.
- f. Be accorded consistent treatment. A cost may not be assigned to a Federal award as a direct cost if any other cost incurred for the same purpose in like circumstances has been allocated to the Federal award as an indirect cost.
- g. Except as otherwise provided for in this Circular, be determined in accordance with generally accepted accounting principles.
- h. Not be included as a cost or used to meet cost sharing or matching requirements of any other Federal award in either the current or a prior period, except as specifically provided by Federal law or regulation.
- i. Be the net of all applicable credits.
- j. Be adequately documented.
- 2. Reasonable costs. A cost is reasonable if, in its nature and 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 cost. The question of reasonableness is particularly important when governmental units or components are predominately federally- funded. In determining 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 governmental unit or the performance of the Federal award.
- b. The restraints or requirements imposed by such factors as: sound business practices; arms length bargaining; Federal, State and other laws and regulations; and, terms and conditions of the Federal award.
- c. Market prices for comparable goods or services.
- d. Whether the individuals concerned acted with prudence in the circumstances considering their responsibilities to the governmental unit, its employees, the public at large, and the Federal Government.
- e. Significant deviations from the established practices of the governmental unit which may unjustifiably increase the Federal award's cost.
- 3. Allocable costs.
- a. 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.
- b. All activities which benefit from the governmental unit's indirect cost, including unallowable activities and services donated to the governmental unit by third parties, will receive an

appropriate allocation of indirect costs.

- c. Any cost allocable to a particular Federal award or cost objective under the principles provided for in this Circular may not be charged to other Federal awards to overcome fund deficiencies, to avoid restrictions imposed by law or terms of the Federal awards, or for other reasons.
- d. Where an accumulation of indirect costs will ultimately result in charges to a Federal award, a cost allocation plan will be required as described in Attachments C, D, and E.
- 4. Applicable credits.
- a. Applicable credits refer to those receipts or reduction of expenditure-type transactions that offset or reduce expense items allocable to Federal awards as direct or indirect costs. Examples of such transactions are: purchase discounts, rebates or allowances, recoveries or indemnities on losses, insurance refunds or rebates, and adjustments of overpayments or erroneous charges. To the extent that such credits accruing to or received by the governmental unit relate to allowable costs, they shall be credited to the Federal award either as a cost reduction or cash refund, as appropriate.
- b. In some instances, the amounts received from the Federal Government to finance activities or service operations of the governmental unit should be treated as applicable credits. Specifically, the concept of netting such credit items (including any amounts used to meet cost sharing or matching requirements) should be recognized in determining the rates or amounts to be charged to Federal awards. (See Attachment B, item 11, "Depreciation and use allowances," for areas of potential application in the matter of Federal financing of activities.)

# D. Composition of Cost

- 1. Total cost. The total cost of Federal awards is comprised of the allowable direct cost of the program, plus its allocable portion of allowable indirect costs, less applicable credits.
- 2. Classification of costs. There is no universal rule for classifying certain costs as either direct or indirect under every accounting system. A cost may be direct with respect to some specific service or function, but indirect with respect to the Federal award or other final cost objective. Therefore, it is essential that each item of cost be treated consistently in like circumstances either as a direct or an indirect cost. Guidelines for determining direct and indirect costs charged to Federal awards are provided in the sections that follow.

#### E. Direct Costs

- 1. General. Direct costs are those that can be identified specifically with a particular final cost objective.
- 2. Application. Typical direct costs chargeable to Federal awards are:
- a. Compensation of employees for the time devoted and identified specifically to the

performance of those awards.

- b. Cost of materials acquired, consumed, or expended specifically for the purpose of those awards.
- c. Equipment and other approved capital expenditures.
- d. Travel expenses incurred specifically to carry out the award.
- 3. Minor items. Any direct cost of a minor amount may be treated as an indirect cost for reasons of practicality where such accounting treatment for that item of cost is consistently applied to all cost objectives.

# F. Indirect Costs

- 1. General. Indirect costs are those: (a) incurred for a common or joint purpose benefiting more than one cost objective, and (b) not readily assignable to the cost objectives specifically benefitted, without effort disproportionate to the results achieved. The term "indirect costs," as used herein, applies to costs of this type originating in the grantee department, as well as those incurred by other departments in supplying goods, services, and facilities. To facilitate equitable distribution of indirect expenses to the cost objectives served, it may be necessary to establish a number of pools of indirect costs within a governmental unit department or in other agencies providing services to a governmental unit department. Indirect cost pools should be distributed to benefitted cost objectives on bases that will produce an equitable result in consideration of relative benefits derived.
- 2. Cost allocation plans and indirect cost proposals. Requirements for development and submission of cost allocation plans and indirect cost rate proposals are contained in Attachments C, D, and E.
- 3. Limitation on indirect or administrative costs.
- a. In addition to restrictions contained in this Circular, there may be laws that further limit the amount of administrative or indirect cost allowed.
- b. Amounts not recoverable as indirect costs or administrative costs under one Federal award may not be shifted to another Federal award, unless specifically authorized by Federal legislation or regulation.
- G. <u>Interagency Services</u>. The cost of services provided by one agency to another within the governmental unit may include allowable direct costs of the service plus a pro rate share of indirect costs. A standard indirect cost allowance equal to ten percent of the direct salary and wage cost of providing the service (excluding overtime, shift premiums, and fringe benefits) may be used in lieu of determining the actual indirect costs of the service. These services do not include centralized services included in central service cost allocation plans as described in Attachment C.

- H. <u>Required Certifications</u>. Each cost allocation plan or indirect cost rate proposal required by Attachments C and E must comply with the following:
- 1. No proposal to establish a cost allocation plan or an indirect cost rate, whether submitted to a Federal cognizant agency or maintained on file by the governmental unit, shall be acceptable unless such costs have been certified by the governmental unit using the Certificate of Cost Allocation Plan or Certificate of Indirect Costs as set forth in Attachments C and E. The certificate must be signed on behalf of the governmental unit by an individual at a level no lower than chief financial officer of the governmental unit that submits the proposal or component covered by the proposal.
- 2. No cost allocation plan or indirect cost rate shall be approved by the Federal Government unless the plan or rate proposal has been certified. Where it is necessary to establish a cost allocation plan or an indirect cost rate and the governmental unit has not submitted a certified proposal for establishing such a plan or rate in accordance with the requirements, the Federal Government may either disallow all indirect costs or unilaterally establish such a plan or rate. Such a plan or rate may be based upon audited historical data or such other data that have been furnished to the cognizant Federal agency and for which it can be demonstrated that all unallowable costs have been excluded. When a cost allocation plan or indirect cost rate is unilaterally established by the Federal Government because of failure of the governmental unit to submit a certified proposal, the plan or rate established will be set to ensure that potentially unallowable costs will not be reimbursed.

# ATTACHMENT B

#### Circular No. A-87

#### SELECTED ITEMS OF COST

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- 1. Advertising and public relations costs
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- 3. Alcoholic beverages
- 4. Audit costs and related services
- 5. Bad debts
- 6. Bonding costs
- 7. Communication costs
- 8. Compensation for personal services
- 9. Contingency provisions
- 10. Defense and prosecution of criminal and civil proceedings, and claims
- 11. Depreciation and use allowances
- 12. Donations and contributions
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- 14. Entertainment costs
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- 18. Gains and losses on disposition of depreciable property and other capital assets and substantial relocation of Federal programs
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- 29. Patent costs
- 30. Plant and homeland security costs
- 31. Pre-award costs
- 32. Professional service costs
- 33. Proposal costs
- 34. Publication and printing costs
- 35. Rearrangement and alteration costs
- 36. Reconversion costs
- 37. Rental costs of building and equipment
- 38. Royalties and other costs for the use of patents
- 39. Selling and marketing
- 40. Taxes
- 41. Termination costs applicable to sponsored agreements
- 42. Training costs
- 43. Travel costs.

Sections 1 through 43 provide 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. A cost is allowable for Federal reimbursement only to the extent of benefits received by Federal awards and its conformance with the general policies and principles stated in Attachment A to this Circular. Failure to mention a particular item of cost in these sections is not intended to imply that it is either allowable or unallowable; rather, determination of allowability in each case should be based on the treatment or standards 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, direct mail, exhibits, electronic or computer transmittals, and the like.

- b. The term public relations includes community relations and means those activities dedicated to maintaining the image of the governmental unit 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 governmental unit of obligations arising under a Federal award;
- (2) The procurement of goods and services for the performance of a Federal award;
- (3) The disposal of scrap or surplus materials acquired in the performance of a Federal award except when governmental units are reimbursed for disposal costs at a predetermined amount; or
- (4) Other specific purposes necessary to meet the requirements of the Federal award.
- d. The only allowable public relations costs are:
- (1) Costs specifically required by the Federal award;
- (2) Costs of communicating with the public and press pertaining to specific activities or accomplishments which result from performance of Federal awards (these costs are considered necessary as part of the outreach effort for the Federal award); 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 keep the public informed on matters of public concern, such as notices of Federal contract/grant awards, financial matters, etc.

- e. Costs identified in subsections c and d if incurred for more than one Federal award or for both sponsored work and other work of the governmental unit, are allowable to the extent that the principles in Attachment A, sections E. ("Direct Costs") and F. ("Indirect Costs") are observed.
- f. Unallowable advertising and public relations costs include the following:
- (1) All advertising and public relations costs other than as specified in subsections c, d, and e;
- (2) Costs of meetings, conventions, convocations, or other events related to other activities of the governmental unit, including:
- (a) Costs of displays, demonstrations, and exhibits;
- (b) Costs of meeting rooms, hospitality suites, and other special facilities used in conjunction with shows and other special events; and
- (c) Salaries and wages of employees 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 governmental unit.
- 2. <u>Advisory councils.</u> Costs incurred by advisory councils or committees are allowable as a direct cost where authorized by the Federal awarding agency or as an indirect cost where allocable to Federal awards.
- 3. Alcoholic beverages. Costs of alcoholic beverages are unallowable.
- 4. Audit costs and related services.
- a. The costs of audits required by , and performed in accordance with, the Single Audit Act, as implemented by Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations" are allowable. Also see 31 USC 7505(b) and section 230 ("Audit Costs") of Circular A-133.
- b. Other audit costs are allowable if included in a cost allocation plan or indirect cost proposal, or if specifically approved by the awarding agency as a direct cost to an award
- c. The cost of agreed-upon procedures engagements to monitor subrecipients who are exempted from A-133 under section 200(d) are allowable, subject to the conditions listed in A-133, section 230 (b)(2).
- 5. <u>Bad debts</u>. Bad debts, including losses (whether actual or estimated) arising from uncollectable accounts and other claims, related collection costs, and related legal costs, are

unallowable.

# 6. 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 governmental unit. They arise also in instances where the governmental unit 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 governmental unit 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.
- 7. <u>Communication costs</u>. Costs incurred for telephone services, local and long distance telephone calls, telegrams, postage, messenger, electronic or computer transmittal services and the like are allowable.

# 8. <u>Compensation for personal services</u>.

- a. General. Compensation for personnel services includes all remuneration, paid currently or accrued, for services rendered during the period of performance under Federal awards, including but not necessarily limited to wages, salaries, and fringe benefits. The costs of such compensation are allowable to the extent that they satisfy the specific requirements of this Circular, and that the total compensation for individual employees:
- (1) Is reasonable for the services rendered and conforms to the established policy of the governmental unit consistently applied to both Federal and non-Federal activities;
- (2) Follows an appointment made in accordance with a governmental unit's laws and rules and meets merit system or other requirements required by Federal law, where applicable; and
- (3) Is determined and supported as provided in subsection h.
- b. Reasonableness. Compensation for employees engaged in work on Federal awards will be considered reasonable to the extent that it is consistent with that paid for similar work in other activities of the governmental unit. In cases where the kinds of employees required for Federal awards are not found in the other activities of the governmental unit, compensation will be considered reasonable to the extent that it is comparable to that paid for similar work in the labor

market in which the employing government competes for the kind of employees involved. Compensation surveys providing data representative of the labor market involved will be an acceptable basis for evaluating reasonableness.

c. Unallowable costs. Costs which are unallowable under other sections of these principles shall not be allowable under this section solely on the basis that they constitute personnel compensation.

# d. Fringe benefits.

- (1) Fringe benefits are allowances and services provided by employers to their employees as compensation in addition to regular salaries and wages. Fringe benefits include, but are not limited to, the costs of leave, employee insurance, pensions, and unemployment benefit plans. Except as provided elsewhere in these principles, the costs of fringe benefits are allowable to the extent that the benefits are reasonable and are required by law, governmental unit-employee agreement, or an established policy of the governmental unit.
- (2) The cost of fringe benefits in the form of regular compensation paid to employees during periods of authorized absences from the job, such as for annual leave, sick leave, holidays, court leave, military leave, and other similar benefits, are allowable if: (a) they are provided under established written leave policies; (b) the costs are equitably allocated to all related activities, including Federal awards; and, (c) the accounting basis (cash or accrual) selected for costing each type of leave is consistently followed by the governmental unit.
- (3) When a governmental unit uses the cash basis of accounting, the cost of leave is recognized in the period that the leave is taken and paid for. Payments for unused leave when an employee retires or terminates employment are allowable in the year of payment provided they are allocated as a general administrative expense to all activities of the governmental unit or component.
- (4) The accrual basis may be only used for those types of leave for which a liability as defined by Generally Accepted Accounting Principles (GAAP) exists when the leave is earned. When a governmental unit uses the accrual basis of accounting, in accordance with GAAP, allowable leave costs are the lesser of the amount accrued or funded.
- (5) The cost of fringe benefits in the form of employer contributions or expenses for social security; employee life, health, unemployment, and worker's compensation insurance (except as indicated in section 22, Insurance and indemnification); pension plan costs (see subsection e.); and other similar benefits are allowable, provided such benefits are granted under established written policies. Such benefits, whether treated as indirect costs or as direct costs, shall be allocated to Federal awards and all other activities in a manner consistent with the pattern of benefits attributable to the individuals or group(s) of employees whose salaries and wages are chargeable to such Federal awards and other activities.
- e. Pension plan costs. Pension plan costs may be computed using a pay-as-you-go method or an acceptable actuarial cost method in accordance with established written policies of the governmental unit.
- (1) For pension plans financed on a pay-as-you-go method, allowable costs will be limited to those representing actual payments to retirees or their beneficiaries.

- (2) Pension costs calculated using an actuarial cost- based method recognized by GAAP are allowable for a given fiscal year if they are funded for that year within six months after the end of that year. Costs funded after the six month period (or a later period agreed to by the cognizant agency) are allowable in the year funded. The cognizant agency may agree to an extension of the six month period if an appropriate adjustment is made to compensate for the timing of the charges to the Federal Government and related Federal reimbursement and the governmental unit's contribution to the pension fund. Adjustments may be made by cash refund or other equitable procedures to compensate the Federal Government for the time value of Federal reimbursements in excess of contributions to the pension fund.
- (3) Amounts funded by the governmental unit in excess of the actuarially determined amount for a fiscal year may be used as the governmental unit's contribution in future periods.
- (4) When a governmental unit converts to an acceptable actuarial cost method, as defined by GAAP, and funds pension costs in accordance with this method, the unfunded liability at the time of conversion shall be allowable if amortized over a period of years in accordance with GAAP.
- (5) The Federal Government shall receive an equitable share of any previously allowed pension costs (including earnings thereon) which revert or inure to the governmental unit in the form of a refund, withdrawal, or other credit.
- f. Post-retirement health benefits. Post-retirement health benefits (PRHB) refers to costs of health insurance or health services not included in a pension plan covered by subsection e. for retirees and their spouses, dependents, and survivors. PRHB costs may be computed using a pay-as-you-go method or an acceptable actuarial cost method in accordance with established written polices of the governmental unit.
- (1) For PRHB financed on a pay as-you-go method, allowable costs will be limited to those representing actual payments to retirees or their beneficiaries.
- (2) PRHB costs calculated using an actuarial cost method recognized by GAAP are allowable if they are funded for that year within six months after the end of that year. Costs funded after the six month period (or a later period agreed to by the cognizant agency) are allowable in the year funded. The cognizant agency may agree to an extension of the six month period if an appropriate adjustment is made to compensate for the timing of the charges to the Federal Government and related Federal reimbursements and the governmental unit's contributions to the PRHB fund. Adjustments may be made by cash refund, reduction in current year's PRHB costs, or other equitable procedures to compensate the Federal Government for the time value of Federal reimbursements in excess of contributions to the PRHB fund.
- (3) Amounts funded in excess of the actuarially determined amount for a fiscal year may be used as the government's contribution in a future period.
- (4) When a governmental unit converts to an acceptable actuarial cost method and funds PRHB costs in accordance with this method, the initial unfunded liability attributable to prior years

shall be allowable if amortized over a period of years in accordance with GAAP, or, if no such GAAP period exists, over a period negotiated with the cognizant agency.

- (5) To be allowable in the current year, the PRHB costs must be paid either to:
- (a) An insurer or other benefit provider as current year costs or premiums, or
- (b) An insurer or trustee to maintain a trust fund or reserve for the sole purpose of providing post-retirement benefits to retirees and other beneficiaries.
- (6) The Federal Government shall receive an equitable share of any amounts of previously allowed post-retirement benefit costs (including earnings thereon) which revert or inure to the governmental unit in the form of a refund, withdrawal, or other credit.

# g. Severance pay.

- (1) Payments in addition to regular salaries and wages made to workers whose employment is being terminated are allowable to the extent that, in each case, they are required by (a) law, (b) employer-employee agreement, or (c) established written policy.
- (2) Severance payments (but not accruals) associated with normal turnover are allowable. Such payments shall be allocated to all activities of the governmental unit as an indirect cost.
- (3) Abnormal or mass severance pay will be considered on a case-by-case basis and is allowable only if approved by the cognizant Federal agency.
- h. Support of salaries and wages. These standards regarding time distribution are in addition to the standards for payroll documentation.
- (1) Charges to Federal awards for salaries and wages, whether treated as direct or indirect costs, will be based on payrolls documented in accordance with generally accepted practice of the governmental unit and approved by a responsible official(s) of the governmental unit.
- (2) No further documentation is required for the salaries and wages of employees who work in a single indirect cost activity.
- (3) Where employees are expected to work solely on a single Federal award or cost objective, charges for their salaries and wages will be supported by periodic certifications that the employees worked solely on that program for the period covered by the certification. These certifications will be prepared at least semi-annually and will be signed by the employee or supervisory official having first hand knowledge of the work performed by the employee.
- (4) Where employees work on multiple activities or cost objectives, a distribution of their salaries or wages will be supported by personnel activity reports or equivalent documentation which meets the standards in subsection (5) unless a statistical sampling system (see subsection (6)) or other substitute system has been approved by the cognizant Federal agency. Such documentary support will be required where employees work on:

- (a) More than one Federal award,
- (b) A Federal award and a non-Federal award,
- (c) An indirect cost activity and a direct cost activity,
- (d) Two or more indirect activities which are allocated using different allocation bases, or
- (e) An unallowable activity and a direct or indirect cost activity.
- (5) Personnel activity reports or equivalent documentation must meet the following standards:
- (a) They must reflect an after-the-fact distribution of the actual activity of each employee,
- (b) They must account for the total activity for which each employee is compensated,
- (c) They must be prepared at least monthly and must coincide with one or more pay periods, and
- (d) They must be signed by the employee.
- (e) Budget estimates or other distribution percentages determined before the services are performed do not qualify as support for charges to Federal awards but may be used for interim accounting purposes, provided that:
- (i) The governmental unit's system for establishing the estimates produces reasonable approximations of the activity actually performed;
- (ii) At least quarterly, comparisons of actual costs to budgeted distributions based on the monthly activity reports are made. Costs charged to Federal awards to reflect adjustments made as a result of the activity actually performed may be recorded annually if the quarterly comparisons show the differences between budgeted and actual costs are less than ten percent; and
- (iii) The budget estimates or other distribution percentages are revised at least quarterly, if necessary, to reflect changed circumstances.
- (6) Substitute systems for allocating salaries and wages to Federal awards may be used in place of activity reports. These systems are subject to approval if required by the cognizant agency. Such systems may include, but are not limited to, random moment sampling, case counts, or other quantifiable measures of employee effort.
- (a) Substitute systems which use sampling methods (primarily for Temporary Assistance to Needy Families (TANF), Medicaid, and other public assistance programs) must meet acceptable statistical sampling standards including:
- (i) The sampling universe must include all of the employees whose salaries and wages are to be allocated based on sample results except as provided in subsection (c);

- (ii) The entire time period involved must be covered by the sample; and
- (iii) The results must be statistically valid and applied to the period being sampled.
- (b) Allocating charges for the sampled employees' supervisors, clerical and support staffs, based on the results of the sampled employees, will be acceptable.
- (c) Less than full compliance with the statistical sampling standards noted in subsection (a) may be accepted by the cognizant agency if it concludes that the amounts to be allocated to Federal awards will be minimal, or if it concludes that the system proposed by the governmental unit will result in lower costs to Federal awards than a system which complies with the standards.
- (7) Salaries and wages of employees used in meeting cost sharing or matching requirements of Federal awards must be supported in the same manner as those claimed as allowable costs under Federal awards.

#### i. Donated services.

- (1) Donated or volunteer services may be furnished to a governmental unit 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. However, the value of donated services may be used to meet cost sharing or matching requirements in accordance with the provisions of the Common Rule.
- (2) The value of donated services utilized in the performance of a direct cost activity shall, when material in amount, be considered in the determination of the governmental unit's indirect costs or rate(s) and, accordingly, shall be allocated a proportionate share of applicable indirect costs.
- (3) To the extent feasible, donated services will be supported by the same methods used by the governmental unit to support the allocability of regular personnel services.
- 9. <u>Contingency provisions</u>. 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 Attachment B, section 22.c.), pension plan reserves (see Attachment B, section 8.e.), and post-retirement health and other benefit reserves (see Attachment B, section 8.f.) computed using acceptable actuarial cost methods.

# 10. Defense and prosecution of criminal and civil proceedings, and claims.

- a. The following costs are unallowable for contracts covered by 10 U.S.C. 2324(k), "Allowable costs under defense contracts."
- (1) Costs incurred in defense of any civil or criminal fraud proceeding or similar proceeding (including filing of false certification brought by the United States where the contractor is found liable or has pleaded nolo contendere to a charge of fraud or similar proceeding (including filing

of a false certification).

- (2) Costs incurred by a contractor in connection with any criminal, civil or administrative proceedings commenced by the United States or a State to the extent provided in 10 U.S.C. 2324(k).
- b. Legal expenses required in the administration of Federal programs are allowable. Legal expenses for prosecution of claims against the Federal Government are unallowable.
- 11. Depreciation and use allowances.
- a. Depreciation and use allowances are means of allocating the cost of fixed assets to periods benefiting from asset use. Compensation for the use of fixed assets on hand may be made through depreciation or use allowances. 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.) except as provided for in subsection g. Except for enterprise funds and internal service funds that are included as part of a State/local cost allocation plan, classes of assets shall be determined on the same basis used for the government-wide financial statements.
- b. The computation of depreciation or use allowances shall be based on the acquisition cost of the assets involved. Where actual cost records have not been maintained, a reasonable estimate of the original acquisition cost may be used. The value of an asset donated to the governmental unit by an unrelated third party shall be its fair market value at the time of donation. Governmental or quasi-governmental organizations located within the same State shall not be considered unrelated third parties for this purpose.
- c. The computation of depreciation or use allowances 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 governmental unit, or a related donor organization, in satisfaction of a matching requirement.
- d. Where the 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, historical usage patterns, technological developments, and the renewal and replacement policies of the governmental unit followed for the individual items or classes of assets involved. In the absence of clear evidence indicating that the expected consumption of the asset will be significantly greater in the early portions than in the later portions of its useful life, the straight line method of depreciation shall be used.

Depreciation methods once used shall not be changed unless approved by the Federal cognizant or awarding agency. When the depreciation method is introduced for application to an asset

previously subject to a use allowance, the annual depreciation charge thereon may not exceed the amount that would have resulted had the depreciation method been in effect from the date of acquisition of the asset. The combination of use allowances and depreciation applicable to the asset shall not exceed the total acquisition cost of the asset or fair market value at time of donation.

- e. When the depreciation method is used for buildings, a building's shell may be segregated from the major component of the building (e.g., plumbing system, heating, and air conditioning system, etc.) and each major component 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. Where the use allowance method is followed, the use allowance for buildings and improvements (including land improvements, such as paved parking areas, fences, and sidewalks) will be computed at an annual rate not exceeding two percent of acquisition costs. The use allowance for equipment will be computed at an annual rate not exceeding 6 2/3 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 condition, 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, modular furniture, carpeting, etc.). Such equipment will be considered as not being permanently fixed to the building if it can be removed without the destruction of, or need for costly or extensive alterations or repairs, to the building or the equipment. Equipment that meets these criteria will be subject to the 6 2/3 percent equipment use allowance limitation.

- g. A reasonable use allowance may be negotiated for any assets that are considered to be fully depreciated, after taking into consideration the amount of depreciation previously charged to the government, the estimated useful life remaining at the time of negotiation, the effect of any increased maintenance charges, decreased efficiency due to age, and any other factors pertinent to the utilization of the asset for the purpose contemplated.
- h. Charges for use allowances or depreciation must be supported by adequate property records. Physical inventories must be taken at least once every two years (a statistical sampling approach is acceptable) to ensure that assets exist, and are in use. Governmental units will manage equipment in accordance with State laws and procedures. When the depreciation method is followed, depreciation records indicating the amount of depreciation taken each period must also be maintained.

# 12. Donations and contributions.

a. Contributions or donations rendered. Contributions or donations, including cash, property, and services, made by the governmental unit, regardless of the recipient, are unallowable.

#### b. Donated services received:

- (1) Donated or volunteer services may be furnished to a governmental unit 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. However, the value of donated services may be used to meet cost sharing or matching requirements in accordance with the Federal Grants Management Common Rule.
- (2) The value of donated services utilized in the performance of a direct cost activity shall, when material in amount, be considered in the determination of the governmental unit's indirect costs or rate(s) and, accordingly, shall be allocated a proportionate share of applicable indirect costs.
- (3) To the extent feasible, donated services will be supported by the same methods used by the governmental unit to support the allocability of regular personnel services.

# 13. Employee morale, health, and welfare costs.

- a. The costs of employee information publications, health or first-aid clinics and/or infirmaries, recreational activities, employee counseling services, and any other expenses incurred in accordance with the governmental unit's established practice or custom for the improvement of working conditions, employer-employee relations, employee morale, and employee performance are allowable.
- b. Such costs will be equitably apportioned to all activities of the governmental unit. Income generated from any of these activities will be offset against expenses.
- 14. <u>Entertainment</u>. Costs of entertainment, including amusement, diversion, and social activities and any costs directly associated with such costs (such as tickets to shows or sports events, meals, lodging, rentals, transportation, and gratuities) are unallowable.

# 15. Equipment and other capital expenditures.

- a. For purposes of this subsection 15, the following definitions apply:
- (1) "Capital Expenditures" means expenditures for the acquisition cost of capital assets (equipment, buildings, land), or expenditures to make improvements to capital assets that materially increase their value or useful life. Acquisition cost means the cost of the asset including the cost to put it in place. Acquisition cost for equipment, for example, means the net invoice price of the 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 may be included in, or excluded from the acquisition cost in accordance with the governmental

unit's regular accounting practices.

- (2) "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 the capitalization level established by the governmental unit for financial statement purposes, or \$5000.
- (3) "Special purpose equipment" means equipment which is used only for research, medical, scientific, or other technical activities. Examples of special purpose equipment include microscopes, x-ray machines, surgical instruments, and spectrometers.
- (4) "General purpose equipment" means equipment, which is not limited to research, medical, scientific or other technical activities. Examples include office equipment and furnishings, modular offices, telephone networks, information technology equipment and systems, air conditioning equipment, reproduction and printing equipment, and motor vehicles.
- b. The following rules of allowability shall apply to equipment and other capital expenditures:
- (1) Capital expenditures for general purpose equipment, buildings, and land are unallowable as direct charges, except where approved in advance by 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 the awarding agency.
- (3) 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.
- (4) When approved as a direct charge pursuant to Attachment B, section 15.b (1), (2), and (3) above, capital expenditures will be charged in the period in which the expenditure is incurred, or as otherwise determined appropriate and negotiated with the awarding agency. In addition, Federal awarding agencies are authorized at their option to waive or delegate the prior approval requirement.
- (5) Equipment and other capital expenditures are unallowable as indirect costs. However, see section 11, Depreciation and use allowance, for rules on the allowability of use allowances or depreciation on buildings, capital improvements, and equipment. Also, see section 37, Rental costs, concerning the allowability of rental costs for land, buildings, and equipment.
- (6) 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 negotiated with the cognizant agency.
- (7) When replacing equipment purchased in whole or in part with Federal funds, the governmental unit may use the equipment to be replaced as a trade-in or sell the property and use

the proceeds to offset the cost of the replacement property.

16. <u>Fines and penalties</u>. Fines, penalties, damages, and other settlements resulting from violations (or alleged violations) of, or failure of the governmental unit to comply with, Federal, State, local, or Indian tribal laws and regulations are unallowable except when incurred as a result of compliance with specific provisions of the Federal award or written instructions by the awarding agency authorizing in advance such payments.

# 17. Fund raising and investment management costs.

- a. Costs of organized fund raising, including financial campaigns, solicitation of gifts and bequests, and similar expenses incurred to raise capital or obtain contributions are unallowable, regardless of the purpose for which the funds will be used.
- b. Costs of investment counsel and staff and similar expenses incurred to enhance income from investments are unallowable. However, such costs associated with investments covering pension, self-insurance, or other funds which include Federal participation allowed by this Circular are allowable.
- c. Fund raising and investment activities shall be allocated an appropriate share of indirect costs under the conditions described in subsection C.3.b. of Attachment A.
- 18. Gains and losses on disposition of depreciable property and other capital assets and substantial relocation of Federal programs.
- a. (1) Gains and losses on the sale, retirement, or other disposition of depreciable property shall be included in the year in which they occur as credits or charges to the asset cost grouping(s) in which the property was included. The amount of the gain or loss to be included as a credit or charge to the appropriate asset 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 account and is reflected in the depreciation allowable under sections 11 and 15.
- (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 subsection 22.d.
- (d) Compensation for the use of the property was provided through use allowances in lieu of depreciation.
- b. Substantial relocation of Federal awards from a facility where the Federal Government

participated in the financing to another facility prior to the expiration of the useful life of the financed facility requires Federal agency approval. The extent of the relocation, the amount of the Federal participation in the financing, and the depreciation charged to date may require negotiation of space charges for Federal awards.

c. Gains or losses of any nature arising from the sale or exchange of property other than the property covered in subsection a., e.g., land or included in the fair market value used in any adjustment resulting from a relocation of Federal awards covered in subsection b. shall be excluded in computing Federal award costs.

# 19. General government expenses.

- a. The general costs of government are unallowable (except as provided in Attachment B, section 43, Travel costs). These include:
- (1) Salaries and expenses of the Office of the Governor of a State or the chief executive of a political subdivision or the chief executive of federally-recognized Indian tribal government;
- (2) Salaries and other expenses of a State legislature, tribal council, or similar local governmental body, such as a county supervisor, city council, school board, etc., whether incurred for purposes of legislation or executive direction;
- (3) Costs of the judiciary branch of a government;
- (4) Costs of prosecutorial activities unless treated as a direct cost to a specific program if authorized by program statute or regulation (however, this does not preclude the allowability of other legal activities of the Attorney General); and
- (5) Costs of other general types of government services normally provided to the general public, such as fire and police, unless provided for as a direct cost under a program statute or regulation.
- b. For federally-recognized Indian tribal governments and Councils Of Governments (COGs), the portion of salaries and expenses directly attributable to managing and operating Federal programs by the chief executive and his staff is allowable
- 20. <u>Goods or services for personal use.</u> Costs of goods or services for personal use of the governmental unit's employees are unallowable regardless of whether the cost is reported as taxable income to the employees.

#### 21. Idle facilities and idle capacity.

- a. As used in this section 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 governmental unit.

- (2) "Idle facilities" means completely unused facilities that are excess to the governmental unit's current needs.
- (3) "Idle capacity" means the unused capacity of partially used facilities. It is the difference between: (a) 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 (b) the extent to which the facility was actually used to meet demands during the accounting period. A multi-shift basis should be used if it can be shown that this amount of usage would normally be expected for the type of facility involved.
- (4) "Cost of idle facilities or idle capacity" means costs such as maintenance, repair, housing, rent, and other related costs, e.g., insurance, interest, property taxes 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 subsection, costs of idle facilities are allowable for a reasonable period of time, ordinarily not to exceed one year, depending on the initiative taken to use, lease, or dispose of such facilities.
- 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 that the capacity is reasonably anticipated to be necessary or was originally reasonable and is not subject to reduction or elimination by use on other Federal awards, subletting, renting, or sale, in accordance with sound business, economic, or security practices. Widespread idle capacity throughout an entire facility or among a group of assets having substantially the same function may be considered idle facilities.

#### 22. Insurance and indemnification.

- a. Costs of insurance required or approved and maintained, pursuant to the Federal award, are allowable.
- b. Costs of other insurance in connection with the general conduct of activities are allowable subject to the following limitations:
- (1) Types and extent and cost of coverage are in accordance with the governmental unit's policy and sound business practice.
- (2) Costs of insurance or of contributions to any reserve covering the risk of loss of, or damage

- to, Federal Government property are unallowable except to the extent that the awarding agency has specifically required or approved such costs.
- c. Actual losses which could have been covered by permissible insurance (through a self-insurance program or otherwise) are unallowable, unless expressly provided for in the Federal award or as described below. However, the Federal Government will participate in actual losses of a self insurance fund that are in excess of reserves. Costs incurred because of losses not covered under nominal deductible insurance coverage provided in keeping with sound management practice, and minor losses not covered by insurance, such as spoilage, breakage, and disappearance of small hand tools, which occur in the ordinary course of operations, are allowable.
- d. Contributions to a reserve for certain self-insurance programs including workers compensation, unemployment compensation, and severance pay are allowable subject to the following provisions:
- (1) The type of coverage and the extent of coverage and the rates and premiums would have been allowed had insurance (including reinsurance) 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 discounted present value of the liability. The rate used for discounting the liability must be determined by giving consideration to such factors as the governmental unit's settlement rate for those liabilities and its investment rate of return.
- (2) Earnings or investment income on reserves must be credited to those reserves.
- (3) Contributions to reserves must be based on sound actuarial principles using historical experience and reasonable assumptions. Reserve levels must be analyzed and updated at least biennially for each major risk being insured and take into account any reinsurance, coinsurance, etc. Reserve levels related to employee-related coverages will normally be limited to the value of claims (a) submitted and adjudicated but not paid, (b) submitted but not adjudicated, and (c) incurred but not submitted. Reserve levels in excess of the amounts based on the above must be identified and justified in the cost allocation plan or indirect cost rate proposal.
- (4) Accounting records, actuarial studies, and cost allocations (or billings) must recognize any significant differences due to types of insured risk and losses generated by the various insured activities or agencies of the governmental unit. If individual departments or agencies of the governmental unit experience significantly different levels of claims for a particular risk, those differences are to be recognized by the use of separate allocations or other techniques resulting in an equitable allocation.
- (5) Whenever funds are transferred from a self-insurance reserve to other accounts (e.g., general fund), refunds shall be made to the Federal Government for its share of funds transferred, including earned or imputed interest from the date of transfer.
- e. Actual claims paid to or on behalf of employees or former employees for workers'

compensation, unemployment compensation, severance pay, and similar employee benefits (e.g., subsection 8.f. for post retirement health benefits), are allowable in the year of payment provided (1) the governmental unit follows a consistent costing policy and (2) they are allocated as a general administrative expense to all activities of the governmental unit.

- f. Insurance refunds shall be credited against insurance costs in the year the refund is received.
- g. Indemnification includes securing the governmental unit against liabilities to third persons and other losses not compensated by insurance or otherwise. The Federal Government is obligated to indemnify the governmental unit only to the extent expressly provided for in the Federal award, except as provided in subsection d.
- h. Costs of commercial insurance that protects against the costs of the contractor for correction of the contractor's own defects in materials or workmanship are unallowable.

# 23. Interest.

- a. Costs incurred for interest on borrowed capital or the use of a governmental unit's own funds, however represented, are unallowable except as specifically provided in subsection b. or authorized by Federal legislation.
- b. Financing costs (including interest) paid or incurred which are associated with the otherwise allowable costs of building acquisition, construction, or fabrication, reconstruction or remodeling completed on or after October 1, 1980 is allowable subject to the conditions in (1) through (4) of this section 23.b. Financing costs (including interest) paid or incurred on or after September 1, 1995 for land or associated with otherwise allowable costs of equipment is allowable, subject to the conditions in (1) through (4).
- (1) The financing is provided (from other than tax or user fee sources) by a bona fide third party external to the governmental unit;
- (2) Thee assets are used in support of Federal awards;
- (3) Earnings on debt service reserve funds or interest earned on borrowed funds pending payment of the construction or acquisition costs are used to offset the current period's cost or the capitalized interest, as appropriate. Earnings subject to being reported to the Federal Internal Revenue Service under arbitrage requirements are excludable.
- (4) For debt arrangements over \$1 million, unless the governmental unit makes an initial equity contribution to the asset purchase of 25 percent or more, the governmental unit shall reduce claims for interest cost by an amount equal to imputed interest earnings on excess cash flow, which is to be calculated as follows. Annually, non-Federal entities 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 cost. For cash flow calculations, the annual inflow figures shall be divided by the number of months in the year

(i.e., 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 cost. 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.

(5) Interest attributable to fully depreciated assets is unallowable.

# 24. Lobbying.

- a. General. The cost of certain influencing activities associated with obtaining grants, contracts, cooperative agreements, or loans is an unallowable cost. Lobbying with respect to certain grants, contracts, cooperative agreements, and loans shall be governed by the common rule, "New Restrictions on Lobbying" published at 55 FR 6736 (February 26, 1990), including definitions, and the Office of Management and Budget "Government-wide Guidance for New Restrictions on Lobbying" and notices published at 54 FR 52306 (December 20, 1989), 55 FR 24540 (June 15, 1990), and 57 FR 1772 (January 15, 1992), respectively.
- b. Executive lobbying costs. Costs incurred in attempting to improperly influence either directly or indirectly, an employee or officer of the Executive Branch of the Federal Government to give consideration or to act regarding a sponsored agreement or a regulatory matter are unallowable. Improper influence means any influence that induces or tends to induce a Federal employee or officer to give consideration or to act regarding a federally-sponsored agreement or regulatory matter on any basis other than the merits of the matter.
- 25. <u>Maintenance</u>, operations, and repairs. Unless prohibited by law, the cost of utilities, insurance, security, janitorial services, elevator service, upkeep of grounds, necessary maintenance, normal repairs and alterations, and the like are allowable to the extent that they: (1) keep property (including Federal property, unless otherwise provided for) 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 appreciably prolong its intended life shall be treated as capital expenditures (see sections *11 and 15*).

# 26. Materials and supplies costs.

- a. Costs incurred for materials, supplies, and fabricated parts necessary to carry out a Federal award are allowable.
- b. Purchased materials and supplies shall be charged at their actual prices, net of applicable credits. Withdrawals from general stores or stockrooms should be charged at their actual net cost under any recognized method of pricing inventory withdrawals, consistently applied. Incoming transportation charges are a proper part of materials and supplies costs.

- c. Only materials and supplies actually used for the performance of a Federal award may be charged as direct costs.
- d. Where federally-donated or furnished materials are used in performing the Federal award, such materials will be used without charge.
- 27. <u>Meetings and conferences.</u> Costs of meetings and conferences, the primary purpose of which is the dissemination of technical information, are allowable. This includes costs of meals, transportation, rental of facilities, speakers' fees, and other items incidental to such meetings or conferences. But see Attachment B, section 14, Entertainment costs.
- 28. Memberships, subscriptions, and professional activity costs.
- a. Costs of the governmental unit's memberships in business, technical, and professional organizations are allowable.
- b. Costs of the governmental unit's subscriptions to business, professional, and technical periodicals are allowable.
- c. Costs of membership in civic and community, social organizations are allowable as a direct cost with the approval of the Federal awarding agency.
- d. Costs of membership in organizations substantially engaged in lobbying are unallowable.

#### 29. Patent costs.

- a. The following costs relating to patent and copyright matters are allowable: (i) cost of preparing disclosures, reports, and other documents required by the Federal award and of searching the art to the extent necessary to make such disclosures; (ii) cost of 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 (but see Attachment B, sections 32, Professional service costs, and 38, Royalties and other costs for use of patents and copyrights).
- b. The following costs related to patent and copyright matter are unallowable:
- (i) Cost of preparing disclosures, reports, and other documents and of searching the art to the extent necessary to make disclosures not required by the award
- (ii) Costs in connection with filing and prosecuting any foreign patent application, or (ii) any United States patent application, where the Federal award does not require conveying title or a royalty-free license to the Federal Government (but see Attachment B, section 38., Royalties and other costs for use of patents and copyrights).

- 30. <u>Plant and homeland security costs.</u> Necessary and reasonable expenses incurred for routine and homeland security to protect facilities, personnel, and work products are allowable. Such costs include, but are not limited to, wages and uniforms of personnel engaged in security activities; equipment; barriers; contractual security services; consultants; etc. Capital expenditures for homeland and plant security purposes are subject to section 15., Equipment and other capital expenditures, of this Circular.
- 31. <u>Pre-award costs</u>. 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.

## 32. 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 governmental unit, 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.

In addition, legal and related services are limited under Attachment B, section 10.

- 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 governmental unit'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 governmental unit's business (i.e., what new problems have arisen).
- (5) Whether the proportion of Federal work to the governmental unit's total business is such as to influence the
- governmental unit 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 available or rendered evidence of bona fide services available or rendered.
- 33. <u>Proposal costs</u>. Costs of preparing proposals for potential Federal awards are allowable. Proposal costs should normally be treated as indirect costs and should be allocated to all activities of the governmental unit utilizing the cost allocation plan and indirect cost rate proposal. However, proposal costs may be charged directly to Federal awards with the prior approval of the Federal awarding agency.

#### 34. 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. Publication costs also include page charges in professional publications.
- 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 governmental unit.
- c. Page charges for professional journal publications are allowable as a necessary part of research costs where:
- (1) The research papers report work supported by the Federal Government: and
- (2) The charges are levied impartially on all research papers published by the journal, whether or not by federally-sponsored authors
- 35. <u>Rearrangement and alteration costs</u>. Costs incurred for ordinary and normal rearrangement and alteration of facilities are allowable. Special arrangements and alterations costs incurred specifically for a Federal award are allowable with the prior approval of the Federal awarding agency.
- 36. <u>Reconversion costs</u>. Costs incurred in the restoration or rehabilitation of the governmental unit's facilities to approximately the same condition existing immediately prior to commencement of Federal awards, less costs related to normal wear and tear, are allowable.
- 37. Rental costs of buildings and equipment.
- a. Subject to the limitations described in subsections b. through d. of this section, 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. Rental arrangements should be

reviewed periodically to determine if circumstances have changed and other options are available.

- b. Rental costs under "sale and lease back" arrangements are allowable only up to the amount that would be allowed had the governmental unit continued to own the property. This amount would include expenses such as depreciation or use allowance, maintenance, taxes, and insurance.
- c. Rental costs under "less-than-arms-length" leases are allowable only up to the amount (as explained in Attachment B, section 37.b) that would be allowed had title to the property vested in the governmental unit. 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 a governmental unit; (ii) governmental units under common control through common officers, directors, or members; and (iii) a governmental unit and a director, trustee, officer, or key employee of the governmental unit or his immediate family, either directly or through corporations, trusts, or similar arrangements in which they hold a controlling interest. For example, a governmental unit may establish a separate corporation for the sole purpose of owning property and leasing it back to the governmental unit.
- d. Rental costs under leases which are required to be treated as capital leases under GAAP are allowable only up to the amount (as explained in subsection b) that would be allowed had the governmental unit purchased the property on the date the lease agreement was executed. The provisions of Financial Accounting Standards Board Statement 13, Accounting for Leases, shall be used to determine whether a lease is a capital lease. Interest costs related to capital leases are allowable to the extent they meet the criteria in Attachment B, section 23. Unallowable costs include amounts paid for profit, management fees, and taxes that would not have been incurred had the governmental unit purchased the facility.
- 38. Royalties and other costs for the use of patents.
- 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

been arrived at as a result of less-than-arm's-length bargaining, e.g.:

- (1) Royalties paid to persons, including corporations, affiliated with the governmental unit.
- (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 a governmental unit.
- c. In any case involving a patent or copyright formerly owned by the governmental unit, the amount of royalty allowed should not exceed the cost which would have been allowed had the governmental unit retained title thereto.
- 39. <u>Selling and marketing.</u> Costs of selling and marketing any products or services of the governmental unit are unallowable (unless allowed under Attachment B, section 1. as allowable public relations costs or under Attachment B, section 33. as allowable proposal costs.

#### 40. Taxes.

- a. Taxes that a governmental unit is legally required to pay are allowable, except for self-assessed taxes that disproportionately affect Federal programs or changes in tax policies that disproportionately affect Federal programs. This provision becomes effective for taxes paid during the governmental unit's first fiscal year that begins on or after January 1, 1998, and applies thereafter.
- b. Gasoline taxes, motor vehicle fees, and other taxes that are in effect user fees for benefits provided to the Federal Government are allowable.
- c. This provision does not restrict the authority of Federal agencies to identify taxes where Federal participation is inappropriate. Where the identification of the amount of unallowable taxes would require an inordinate amount of effort, the cognizant agency may accept a reasonable approximation thereof.
- 41. <u>Termination costs applicable to sponsored agreements.</u> Termination of awards generally gives rise to the incurrence of costs, or the need for special treatment of costs, which would not have arisen had the Federal 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. The cost of items reasonably usable on the governmental unit's other work shall not be allowable unless the governmental unit 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 governmental unit, the awarding agency should consider the governmental unit's plans and orders for current and scheduled activity.

Contemporaneous purchases of common items by the governmental unit shall be regarded as evidence that such items are reasonably usable on the governmental unit's other work. Any acceptance of common items as allocable to the terminated portion of the Federal 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. If in a particular case, despite all reasonable efforts by the governmental unit, 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 governmental unit to discontinue such costs shall be unallowable.
- c. Loss of useful value of special tooling, machinery, and equipment is generally allowable if:
- (1) Such special tooling, special machinery, or equipment is not reasonably capable of use in the other work of the governmental unit,
- (2) The interest of the Federal Government is protected by transfer of title or by other means deemed appropriate by the awarding agency, and
- (3) The loss of useful value for any one terminated Federal award is limited to that portion of the acquisition cost which bears the same ratio to the total acquisition cost as the terminated portion of the Federal award bears to the entire terminated Federal award and other Federal awards for which the special tooling, machinery, or equipment was acquired.
- d. Rental costs under unexpired leases are generally allowable where clearly shown to have been reasonably necessary for the performance of the terminated Federal award less the residual value of such leases, if:
- (1) the amount of such rental claimed does not exceed the reasonable use value of the property leased for the period of the Federal award and such further period as may be reasonable, and
- (2) the governmental unit 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 Federal award, and of reasonable restoration required by the provisions of the lease.
- e. Settlement expenses including the following are generally allowable:
- (1) Accounting, legal, clerical, and similar costs reasonably necessary for:
- (a) The preparation and presentation to the awarding agency of settlement claims and supporting data with respect to the terminated portion of the Federal award, unless the termination is for default (see Subpart \_\_.44 of the Grants Management Common Rule implementing OMB Circular A-102); 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 Federal award, except when grantees or contractors are reimbursed for disposals at a predetermined amount in accordance with Subparts\_\_.31 and \_\_\_.32 of the Grants Management Common Rule implementing OMB Circular A-102.
- f. Claims under subawards, including the allocable portion of claims which are common to the Federal award, and to other work of the governmental unit are generally allowable.

An appropriate share of the governmental unit'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.

42. Training costs. The cost of training provided for employee development is allowable.

#### 43. Travel costs.

- a. General. 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 governmental unit. Such costs may be charged on an actual cost 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 is applied to an entire trip and not to selected days of the trip, and results in charges consistent with those normally allowed in like circumstances in the governmental unit's non-federally-sponsored activities. Notwithstanding the provisions of Attachment B, section 19, General government expenses, travel costs of officials covered by that section are allowable with the prior approval of an awarding agency when they are specifically related to Federal awards.
- b. Lodging and subsistence. Costs incurred by employees and officers for travel, including costs of lodging, other subsistence, and incidental expenses, shall be considered reasonable and allowable only to the extent such costs do not exceed charges normally allowed by the governmental unit in its regular operations as the result of the governmental unit's written travel policy. In the absence of an acceptable, written governmental unit policy regarding travel costs, the rates and amounts established under subchapter I of Chapter 57, Title 5, United States Code ("Travel and Subsistence Expenses; Mileage Allowances"), or by the Administrator of General Services, or by the President (or his or her designee) pursuant to any provisions of such subchapter shall apply to travel under Federal awards (48 CFR 31.205-46(a)).

#### c. Commercial air travel.

- (1) Airfare costs in excess of the customary standard commercial airfare (coach or equivalent), Federal Government contract airfare (where authorized and available), or the lowest commercial discount airfare are unallowable except when such accommodations would:
  - (a) require circuitous routing;
  - (b) require travel during unreasonable hours;
  - (c) excessively prolong travel;
  - (d) result in additional costs that would offset the transportation savings; or
- (e) offer accommodations not reasonably adequate for the traveler's medical needs. The governmental unit must justify and document these conditions on a case-by-case basis in order for the use of first-class airfare to be allowable in such cases.
- (2) Unless a pattern of avoidance is detected, the Federal Government will generally not question a governmental unit's determinations that customary standard airfare or other discount airfare is unavailable for specific trips if the governmental unit can demonstrate either of the following: (a) that such airfare was not available in the specific case; or (b) that it is the governmental unit's overall practice to make routine use of such airfare.
- d. Air travel by other than commercial carrier. Costs of travel by governmental unit-owned, leased, or -chartered aircraft include the cost of lease, charter, operation (including personnel costs), maintenance, depreciation, insurance, and other related costs. The portion of such costs that exceeds the cost of allowable commercial air travel, as provided for in subsection c., is unallowable.
- e. Foreign travel. 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 receive such approval. For purposes of this provision, "foreign travel" includes any travel outside Canada, Mexico, the United States, and any United States territories and possessions. However, the term "foreign travel" for a governmental unit located in a foreign country means travel outside that country.

ATTACHMENT C

Circular No. A-87

#### STATE/LOCAL-WIDE CENTRAL SERVICE COST ALLOCATION PLANS

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- A. General.

- 1. Most governmental units provide certain services, such as motor pools, computer centers, purchasing, accounting, etc., to operating agencies on a centralized basis. Since federally-supported awards are performed within the individual operating agencies, there needs to be a process whereby these central service costs can be identified and assigned to benefitted activities on a reasonable and consistent basis. The central service cost allocation plan provides that process. All costs and other data used to distribute the costs included in the plan should be supported by formal accounting and other records that will support the propriety of the costs assigned to Federal awards.
- 2. Guidelines and illustrations of central service cost allocation plans are provided in a brochure published by the Department of Health and Human Services entitled "A Guide for State and Local Government Agencies: Cost Principles and Procedures for Establishing Cost Allocation Plans and Indirect Cost Rates for Grants and Contracts with the Federal Government." A copy of this brochure may be obtained from the Superintendent of Documents, U.S. Government Printing Office.

#### B. Definitions.

- 1. "Billed central services" means central services that are billed to benefitted agencies and/or programs on an individual fee-for-service or similar basis. Typical examples of billed central services include computer services, transportation services, insurance, and fringe benefits.
- 2. "Allocated central services" means central services that benefit operating agencies but are not billed to the agencies on a fee-for-service or similar basis. These costs are allocated to benefitted agencies on some reasonable basis. Examples of such services might include general accounting, personnel administration, purchasing, etc.
- 3. "Agency or operating agency" means an organizational unit or sub-division within a governmental unit that is responsible for the performance or administration of awards or activities of the governmental unit.
- C. <u>Scope of the Central Service Cost Allocation Plans</u>. The central service cost allocation plan will include all central service costs that will be claimed (either as a billed or an allocated cost) under Federal awards and will be documented as described in section E. Costs of central services omitted from the plan will not be reimbursed.

#### D. Submission Requirements.

1. Each State will submit a plan to the Department of Health and Human Services for each year in which it claims central service costs under Federal awards. The plan should include (a) a projection of the next year's allocated central service cost (based either on actual costs for the most recently completed year or the budget projection for the coming year), and (b) a reconciliation of actual allocated central service costs to the estimated costs used for either the most recently completed year or the year immediately preceding the most recently completed year.

- 2. Each local government that has been designated as a "major local government" by the Office of Management and Budget (OMB) is also required to submit a plan to its cognizant agency annually. OMB periodically lists major local governments in the Federal Register.
- 3. All other local governments claiming central service costs must develop a plan in accordance with the requirements described in this Circular and maintain the plan and related supporting documentation for audit. These local governments are not required to submit their plans for Federal approval unless they are specifically requested to do so by the cognizant agency. Where a local government only receives funds as a sub-recipient, the primary recipient will be responsible for negotiating indirect cost rates and/or monitoring the sub-recipient's plan.
- 4. All central service cost allocation plans will be prepared and, when required, submitted within six months prior to the beginning of each of the governmental unit's fiscal years in which it proposes to claim central service costs. Extensions may be granted by the cognizant agency on a case-by-case basis.
- E. <u>Documentation Requirements for Submitted Plans</u>. The documentation requirements described in this section may be modified, expanded, or reduced by the cognizant agency on a case-by-case basis. For example, the requirements may be reduced for those central services which have little or no impact on Federal awards. Conversely, if a review of a plan indicates that certain additional information is needed, and will likely be needed in future years, it may be routinely requested in future plan submissions. Items marked with an asterisk (\*) should be submitted only once; subsequent plans should merely indicate any changes since the last plan.
- 1. General. All proposed plans must be accompanied by the following: an organization chart sufficiently detailed to show operations including the central service activities of the State/local government whether or not they are shown as benefiting from central service functions; a copy of the Comprehensive Annual Financial Report (or a copy of the Executive Budget if budgeted costs are being proposed) to support the allowable costs of each central service activity included in the plan; and, a certification (see subsection 4.) that the plan was prepared in accordance with this Circular, contains only allowable costs, and was prepared in a manner that treated similar costs consistently among the various Federal awards and between Federal and non-Federal awards/activities.
- 2. Allocated central services. For each allocated central service, the plan must also include the following: a brief description of the service\*, an identification of the unit rendering the service and the operating agencies receiving the service, the items of expense included in the cost of the service, the method used to distribute the cost of the service to benefitted agencies, and a summary schedule showing the allocation of each service to the specific benefitted

agencies. If any self-insurance funds or fringe benefits costs are treated as allocated (rather than billed) central services, documentation discussed in subsections 3.b. and c. shall also be included.

3. Billed services.

a. General. The information described below shall be provided for all billed central services, including internal service funds, self-insurance funds, and fringe benefit funds.

#### b. Internal service funds.

- (1) For each internal service fund or similar activity with an operating budget of \$5 million or more, the plan shall include: a brief description of each service; a balance sheet for each fund based on individual accounts contained in the governmental unit's accounting system; a revenue/expenses statement, with revenues broken out by source, e.g., regular billings, interest earned, etc.; a listing of all non-operating transfers (as defined by Generally Accepted Accounting Principles (GAAP)) into and out of the fund; a description of the procedures (methodology) used to charge the costs of each service to users, including how billing rates are determined; a schedule of current rates; and, a schedule comparing total revenues (including imputed revenues) generated by the service to the allowable costs of the service, as determined under this Circular, with an explanation of how variances will be handled.
- (2) Revenues shall consist of all revenues generated by the service, including unbilled and uncollected revenues. If some users were not billed for the services (or were not billed at the full rate for that class of users), a schedule showing the full imputed revenues associated with these users shall be provided. Expenses shall be broken out by object cost categories (e.g., salaries, supplies, etc.).
- c. Self-insurance funds. For each self-insurance fund, the plan shall include: the fund balance sheet; a statement of revenue and expenses including a summary of billings and claims paid by agency; a listing of all non-operating transfers into and out of the fund; the type(s) of risk(s) covered by the fund (e.g., automobile liability, workers' compensation, etc.); an explanation of how the level of fund contributions are determined, including a copy of the current actuarial report (with the actuarial assumptions used) if the contributions are determined on an actuarial basis; and, a description of the procedures used to charge or allocate fund contributions to benefitted activities. Reserve levels in excess of claims (1) submitted and adjudicated but not paid, (2) submitted but not adjudicated, and (3) incurred but not submitted must be identified and explained.
- d. Fringe benefits. For fringe benefit costs, the plan shall include: a listing of fringe benefits provided to covered employees, and the overall annual cost of each type of benefit; current fringe benefit policies\*; and procedures used to charge or allocate the costs of the benefits to benefitted activities. In addition, for pension and post-retirement health insurance plans, the following information shall be provided: the governmental unit's funding policies, e.g., legislative bills, trust agreements, or State-mandated contribution rules, if different from actuarially determined rates; the pension plan's costs accrued for the year; the amount funded, and date(s) of funding; a copy of the current actuarial report (including the actuarial assumptions); the plan trustee's report; and, a schedule from the activity showing the value of the interest cost associated with late funding.
- 4. Required certification. Each central service cost allocation plan will be accompanied by a certification in the following form:

#### CERTIFICATE OF COST ALLOCATION PLAN

This is to certify that I have reviewed the cost allocation plan submitted herewith and to the best of my knowledge and belief:

- (1) All costs included in this proposal [identify date] to establish cost allocations or billings for [identify period covered by plan] are allowable in accordance with the requirements of OMB Circular A-87, "Cost Principles for State, Local, and Indian Tribal Governments," and the Federal award(s) to which they apply. Unallowable costs have been adjusted for in allocating costs as indicated in the cost allocation plan.
- (2) All costs included in this proposal are properly allocable to Federal awards on the basis of a beneficial or causal relationship between the expenses incurred and the awards to which they are allocated in accordance with applicable requirements. Further, the same costs that have been treated as indirect costs have not been claimed as direct costs. Similar types of costs have been accounted for consistently.

I declare that the foregoing is true and correct.	
Governmental Unit:	
Signature:	
Name of Official:	
Title:	
Date of Execution:	

- F. Negotiation and Approval of Central Service Plans.
- 1. All proposed central service cost allocation plans that are required to be submitted will be reviewed, negotiated, and approved by the Federal cognizant agency on a timely basis. The cognizant agency will review the proposal within six months of receipt of the proposal and either negotiate/approve the proposal or advise the governmental unit of the additional documentation needed to support/evaluate the proposed plan or the changes required to make the proposal acceptable. Once an agreement with the governmental unit has been reached, the agreement will be accepted and used by all Federal agencies, unless prohibited or limited by statute. Where a Federal funding agency has reason to believe that special operating factors affecting its awards necessitate special consideration, the funding agency will, prior to the time the plans are negotiated, notify the cognizant agency.
- 2. The results of each negotiation shall be formalized in a written agreement between the cognizant agency and the governmental unit. This agreement will be subject to re-opening if the agreement is subsequently found to violate a statute or the information upon which the plan was negotiated is later found to be materially incomplete or inaccurate. The results of the negotiation shall be made available to all Federal agencies for their use.

3. Negotiated cost allocation plans based on a proposal later found to have included costs that: (a) are unallowable (i) as specified by law or regulation, (ii) as identified in Attachment B of this Circular, or (iii) by the terms and conditions of Federal awards, or (b) are unallowable because they are clearly not allocable to Federal awards, shall be adjusted, or a refund shall be made at the option of the Federal cognizant agency. These adjustments or refunds are designed to correct the plans and do not constitute a reopening of the negotiation.

#### G. Other Policies.

- 1. Billed central service activities. Each billed central service activity must separately account for all revenues (including imputed revenues) generated by the service, expenses incurred to furnish the service, and profit/loss.
- 2. Working capital reserves. Internal service funds are dependent upon a reasonable level of working capital reserve to operate from one billing cycle to the next. Charges by an internal service activity to provide for the establishment and maintenance of a reasonable level of working capital reserve, in addition to the full recovery of costs, are allowable. A working capital reserve as part of retained earnings of up to 60 days cash expenses for normal operating purposes is considered reasonable. A working capital reserve exceeding 60 days may be approved by the cognizant Federal agency in exceptional cases.
- 3. Carry-forward adjustments of allocated central service costs. Allocated central service costs are usually negotiated and approved for a future fiscal year on a "fixed with carry-forward" basis. Under this procedure, the fixed amounts for the future year covered by agreement are not subject to adjustment for that year. However, when the actual costs of the year involved become known, the differences between the fixed amounts previously approved and the actual costs will be carried forward and used as an adjustment to the fixed amounts established for a later year. This "carry-forward" procedure applies to all central services whose costs were fixed in the approved plan. However, a carry-forward adjustment is not permitted, for a central service activity that was not included in the approved plan, or for unallowable costs that must be reimbursed immediately.
- 4. Adjustments of billed central services. Billing rates used to charge Federal awards shall be based on the estimated costs of providing the services, including an estimate of the allocable central service costs. A comparison of the revenue generated by each billed service (including total revenues whether or not billed or collected) to the actual allowable costs of the service will be made at least annually, and an adjustment will be made for the difference between the revenue and the allowable costs. These adjustments will be made through one of the following adjustment methods: (a) a cash refund to the Federal Government for the Federal share of the adjustment, (b) credits to the amounts charged to the individual programs, (c) adjustments to future billing rates, or (d) adjustments to allocated central service costs. Adjustments to allocated central services will not be permitted where the total amount of the adjustment for a particular service (Federal share and non-Federal) share exceeds \$500,000.
- 5. Records retention. All central service cost allocation plans and related documentation used as a basis for claiming costs under Federal awards must be retained for audit in accordance with the

records retention requirements contained in the Common Rule.

- 6. Appeals. If a dispute arises in the negotiation of a plan between the cognizant agency and the governmental unit, the dispute shall be resolved in accordance with the appeals procedures of the cognizant agency.
- 7. OMB assistance. To the extent that problems are encountered among the Federal agencies and/or governmental units in connection with the negotiation and approval process, OMB will lend assistance, as required, to resolve such problems in a timely manner.

ATTACHMENT D

Circular No. A-87

#### PUBLIC ASSISTANCE COST ALLOCATION PLANS

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A. General. Federally-financed programs administered by State public assistance agencies are funded predominately by the Department of Health and Human Services (HHS). In support of its stewardship requirements, HHS has published requirements for the development, documentation, submission, negotiation, and approval of public assistance cost allocation plans in Subpart E of 45 CFR Part 95. All administrative costs (direct and indirect) are normally charged to Federal awards by implementing the public assistance cost allocation plan. This Attachment extends these requirements to all Federal agencies whose programs are administered by a State public assistance agency. Major federally-financed programs typically administered by State public assistance agencies include: *Temporary Assistance to Needy Families (TANF)*, Medicaid, Food Stamps, Child Support Enforcement, Adoption Assistance and Foster Care, and Social Services Block Grant.

#### B. Definitions.

- 1. "State public assistance agency" means a State agency administering or supervising the administration of one or more public assistance programs operated by the State as identified in Subpart E of 45 CFR Part 95. For the purpose of this Attachment, these programs include all programs administered by the State public assistance agency.
- 2. "State public assistance agency costs" means all costs incurred by, or allocable to, the State public assistance agency, except expenditures for financial assistance, medical vendor

payments, food stamps, and payments for services and goods provided directly to program recipients.

C. <u>Policy</u>. State public assistance agencies will develop, document and implement, and the Federal Government will review, negotiate, and approve, public assistance cost allocation plans in accordance with Subpart E of 45 CFR Part 95. The plan will include all programs administered by the State public assistance agency. Where a letter of approval or disapproval is transmitted to a State public assistance agency in accordance with Subpart E, the letter will apply to all Federal agencies and programs. The remaining sections of this Attachment (except for the requirement for certification) summarize the provisions of Subpart E of 45 CFR Part 95.

#### D. Submission, Documentation, and Approval of Public Assistance Cost Allocation Plans.

- 1. State public assistance agencies are required to promptly submit amendments to the cost allocation plan to HHS for review and approval.
- 2. Under the coordination process outlined in subsection E, affected Federal agencies will review all new plans and plan amendments and provide comments, as appropriate, to HHS. The effective date of the plan or plan amendment will be the first day of the quarter following the submission of the plan or amendment, unless another date is specifically approved by HHS. HHS, as the cognizant agency acting on behalf of all affected Federal agencies, will, as necessary, conduct negotiations with the State public assistance agency and will inform the State agency of the action taken on the plan or plan amendment.

#### E. Review of Implementation of Approved Plans.

- 1. Since public assistance cost allocation plans are of a narrative nature, the review during the plan approval process consists of evaluating the appropriateness of the proposed groupings of costs (cost centers) and the related allocation bases. As such, the Federal Government needs some assurance that the cost allocation plan has been implemented as approved. This is accomplished by reviews by the funding agencies, single audits, or audits conducted by the cognizant audit agency.
- 2. Where inappropriate charges affecting more than one funding agency are identified, the cognizant HHS cost negotiation office will be advised and will take the lead in resolving the issue(s) as provided for in Subpart E of 45 CFR Part 95.
- 3. If a dispute arises in the negotiation of a plan or from a disallowance involving two or more

funding agencies, the dispute shall be resolved in accordance with the appeals procedures set out in 45 CFR Part 75. Disputes involving only one funding agency will be resolved in accordance with the funding agency's appeal process.

- 4. To the extent that problems are encountered among the Federal agencies and/or governmental units in connection with the negotiation and approval process, the Office of Management and Budget will lend assistance, as required, to resolve such problems in a timely manner.
- F. <u>Unallowable Costs</u>. Claims developed under approved cost allocation plans will be based on allowable costs as identified in this Circular. Where unallowable costs have been claimed and reimbursed, they will be refunded to the program that reimbursed the unallowable cost using one of the following methods: (a) a cash refund, (b) offset to a subsequent claim, or (c) credits to the amounts charged to individual awards.

ATTACHMENT E

Circular No. A-87

#### STATE AND LOCAL INDIRECT COST RATE PROPOSALS

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#### A. General.

- 1. Indirect costs are those that have been incurred for common or joint purposes. These costs benefit more than one cost objective and cannot be readily identified with a particular final cost objective without effort disproportionate to the results achieved. After direct costs have been determined and assigned directly to Federal awards and other activities as appropriate, indirect costs are those remaining to be allocated to benefitted cost objectives. A cost may not be allocated to a Federal award as an indirect cost if any other cost incurred for the same purpose, in like circumstances, has been assigned to a Federal award as a direct cost.
- 2. Indirect costs include (a) the indirect costs originating in each department or agency of the governmental unit carrying out Federal awards and (b) the costs of central governmental services distributed through the central service cost allocation plan (as described in Attachment C) and not otherwise treated as direct costs.
- 3. Indirect costs are normally charged to Federal awards by the use of an indirect cost rate. A separate indirect cost rate(s) is usually necessary for each department or agency of the

governmental unit claiming indirect costs under Federal awards. Guidelines and illustrations of indirect cost proposals are provided in a brochure published by the Department of Health and Human Services entitled "A Guide for State and Local Government Agencies: Cost Principles and Procedures for Establishing Cost Allocation Plans and Indirect Cost Rates for Grants and Contracts with the Federal Government." A copy of this brochure may be obtained from the Superintendent of Documents, U.S. Government Printing Office.

- 4. Because of the diverse characteristics and accounting practices of governmental units, the types of costs which may be classified as indirect costs cannot be specified in all situations. However, typical examples of indirect costs may include certain State/local-wide central service costs, general administration of the grantee department or agency, accounting and personnel services performed within the grantee department or agency, depreciation or use allowances on buildings and equipment, the costs of operating and maintaining facilities, etc.
- 5. This Attachment does not apply to State public assistance agencies. These agencies should refer instead to Attachment D.

#### B. Definitions.

- 1. "Indirect cost rate proposal" means the documentation prepared by a governmental unit or subdivision thereof to substantiate its request for the establishment of an indirect cost rate.
- 2. "Indirect cost rate" is a device for determining in a reasonable manner the proportion of indirect costs each program should bear. It is the ratio (expressed as a percentage) of the indirect costs to a direct cost base.
- 3. "Indirect cost pool" is the accumulated costs that jointly benefit two or more programs or other cost objectives.
- 4. "Base" means the accumulated direct costs (normally either total direct salaries and wages or total direct costs exclusive of any extraordinary or distorting expenditures) used to distribute indirect costs to individual Federal awards. The direct cost base selected should result in each award bearing a fair share of the indirect costs in reasonable relation to the benefits received from the costs.
- 5. "Predetermined rate" means an indirect cost rate, applicable to a specified current or future period, usually the governmental unit's fiscal year. This rate is based on an estimate of the costs to be incurred during the period. Except under very unusual circumstances, a predetermined rate is not subject to adjustment. (Because of legal constraints, predetermined rates are not permitted for Federal contracts; they may, however, be used for grants or cooperative agreements.) Predetermined rates may not be used by governmental units that have not submitted and negotiated the rate with the cognizant agency. In view of the potential advantages offered by this procedure, negotiation of predetermined rates for indirect costs for a period of two to four years should be the norm in those situations where the cost experience and other pertinent facts available are deemed sufficient to enable the parties involved to reach an informed judgment as to the probable level of indirect costs during the ensuing accounting periods.

- 6. "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, allowable costs of the period covered by the rate is carried forward as an adjustment to the rate computation of a subsequent period.
- 7. "Provisional rate" means a temporary indirect cost rate applicable to a specified period which is used for funding, interim reimbursement, and reporting indirect costs on Federal awards pending the establishment of a "final" rate for that period.
- 8. "Final rate" means an indirect cost rate applicable to a specified past period which is based on the actual allowable costs of the period. A final audited rate is not subject to adjustment.
- 9. "Base period" for the allocation of indirect costs is the period in which such costs are incurred and accumulated for allocation to activities performed in that period. The base period normally should coincide with the governmental unit's fiscal year, but in any event, shall be so selected as to avoid inequities in the allocation of costs.

#### C. Allocation of Indirect Costs and Determination of Indirect Cost Rates.

#### 1. General.

- a. Where a governmental unit's department or agency has only one major function, or where all its major functions benefit from the 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 subsection 2.
- b. Where a governmental unit's department or agency has several major functions which benefit from its indirect costs in varying degrees, the allocation of indirect costs may require the accumulation of such costs into separate cost groupings which then are allocated individually to benefitted 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. 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 subsections 2, 3 and 4.

#### 2. Simplified method.

a. Where a grantee agency's major functions benefit from its indirect costs to approximately the same degree, the allocation of indirect costs may be accomplished by (1) classifying the grantee agency's total costs for the base period as either direct or indirect, and (2) 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 Federal 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 a governmental unit's department or agency has only one major function encompassing a number of individual

projects or activities, and may be used where the level of Federal awards to that department or agency is relatively small.

- b. Both the direct costs and the indirect costs shall exclude capital expenditures and unallowable costs. However, unallowable costs must be included in the direct costs if they represent activities to which indirect costs are properly allocable.
- c. The distribution base may be (1) total direct costs (excluding capital expenditures and other distorting items, such as pass-through funds, major subcontracts, etc.), (2) direct salaries and wages, or (3) another base which results in an equitable distribution.
- 3. Multiple allocation base method.
- a. Where a grantee agency's indirect costs benefit its major functions in varying degrees, such costs shall be accumulated into separate cost groupings. Each grouping shall then be allocated individually to benefitted functions by means of a base which best measures the relative benefits.
- b. The cost groupings should be established so as to permit the allocation of each grouping on the basis of benefits provided to the major functions. Each grouping should constitute a pool of expenses that are of like character in terms of the functions they benefit and in terms of the allocation base which best measures the relative benefits provided to each function. The number of separate groupings should be held within practical limits, taking into consideration the materiality of the amounts involved and the degree of precision needed.
- c. Actual conditions must be taken into account in selecting the base to be used in allocating the expenses in each grouping to benefitted functions. When an allocation can be made by assignment of a cost grouping directly to the function benefitted, the allocation shall be made in that manner. When the expenses in a grouping are more general in nature, the allocation should be made through the use of a selected base which produces results that are equitable to both the Federal Government and the governmental unit. In general, any cost element or related factor associated with the governmental unit's activities is potentially adaptable for use as an allocation base provided that: (1) it can readily be expressed in terms of dollars or other quantitative measures (total direct costs, direct salaries and wages, staff hours applied, square feet used, hours of usage, number of documents processed, population served, and the like), and (2) it is common to the benefitted functions during the base period.
- d. Except where a special indirect cost rate(s) is required in accordance with subsection 4, 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 Federal awards included in that function by use of a single indirect cost rate.
- e. The distribution base used in computing the indirect cost rate for each function may be (1) total direct costs (excluding capital expenditures and other distorting items such as pass-through funds, major subcontracts, etc.), (2) direct salaries and wages, or (3) another base which results in an equitable distribution. An indirect cost rate should be developed for each separate indirect

cost pool developed. The rate in each case should be stated as the percentage relationship between the particular indirect cost pool and the distribution base identified with that pool.

#### 4. Special indirect cost rates.

a. In some instances, a single indirect cost rate for all activities of a grantee department or agency or for each major function of the agency may not be appropriate. It may not take into account those different factors which may substantially affect the indirect costs applicable to a particular program or group of programs. The factors may include the physical location of the work, the level of administrative support required, the nature of the facilities or other resources employed, the organizational arrangements used, or any combination thereof. When a particular award is carried out 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 that award. 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 that: (1) the rate differs significantly from the rate which would have been developed under subsections 2. and 3., and (2) the award to which the rate would apply is material in amount.

b. Although this Circular adopts the concept of the full allocation of indirect costs, there are some Federal statutes which restrict the reimbursement of certain indirect costs. Where such restrictions exist, it may be necessary to develop a special rate for the affected award. Where a "restricted rate" is required, the procedure for developing a non-restricted rate will be used except for the additional step of the elimination from the indirect cost pool those costs for which the law prohibits reimbursement.

#### D. Submission and Documentation of Proposals.

- 1. Submission of indirect cost rate proposals.
- a. All departments or agencies of the governmental unit desiring to claim indirect costs under Federal awards must prepare an indirect cost rate proposal and related documentation to support those costs. The proposal and related documentation must be retained for audit in accordance with the records retention requirements contained in the Common Rule.
- b. A governmental unit for which a cognizant agency assignment has been specifically designated must submit its indirect cost rate proposal to its cognizant agency. The Office of Management and Budget (OMB) will periodically publish lists of governmental units identifying the appropriate Federal cognizant agencies. The cognizant agency for all governmental units or agencies not identified by OMB will be determined based on the Federal agency providing the largest amount of Federal funds. In these cases, a governmental unit must develop an indirect cost proposal in accordance with the requirements of this Circular and maintain the proposal and related supporting documentation for audit. These governmental units are not required to submit their proposals unless they are specifically requested to do so by the cognizant agency. Where a local government only receives funds as a sub-recipient, the primary recipient will be responsible for negotiating and/or monitoring the sub-recipient's plan.

- c. Each Indian tribal government desiring reimbursement of indirect costs must submit its indirect cost proposal to the Department of the Interior (its cognizant Federal agency).
- d. Indirect cost proposals must be developed (and, when required, submitted) within six months after the close of the governmental unit's fiscal year, unless an exception is approved by the cognizant Federal agency. If the proposed central service cost allocation plan for the same period has not been approved by that time, the indirect cost proposal may be prepared including an amount for central services that is based on the latest federally-approved central service cost allocation plan. The difference between these central service amounts and the amounts ultimately approved will be compensated for by an adjustment in a subsequent period.
- 2. Documentation of proposals. The following shall be included with each indirect cost proposal:
- a. The rates proposed, including subsidiary work sheets and other relevant data, cross referenced and reconciled to the financial data noted in subsection b. Allocated central service costs will be supported by the summary table included in the approved central service cost allocation plan. This summary table is not required to be submitted with the indirect cost proposal if the central service cost allocation plan for the same fiscal year has been approved by the cognizant agency and is available to the funding agency.
- b. A copy of the financial data (financial statements, comprehensive annual financial report, executive budgets, accounting reports, etc.) upon which the rate is based. Adjustments resulting from the use of unaudited data will be recognized, where appropriate, by the Federal cognizant agency in a subsequent proposal.
- c. The approximate amount of direct base costs incurred under Federal awards. These costs should be broken out between salaries and wages and other direct costs.
- d. A chart showing the organizational structure of the agency during the period for which the proposal applies, along with a functional statement(s) noting the duties and/or responsibilities of all units that comprise the agency. (Once this is submitted, only revisions need be submitted with subsequent proposals.)
- 3. Required certification. Each indirect cost rate proposal shall be accompanied by a certification in the following form:

#### CERTIFICATE OF INDIRECT COSTS

This is to certify that I have reviewed the indirect cost rate proposal submitted herewith and to the best of my knowledge and belief:

(1) All costs included in this proposal [identify date] to establish billing or final indirect costs rates for [identify period covered by rate] are allowable in accordance with the requirements of the Federal award(s) to which they apply and OMB Circular A-87, "Cost Principles for State, Local, and Indian Tribal Governments." Unallowable costs have been adjusted for in allocating costs as indicated in the cost allocation plan.

(2) All costs included in this proposal are properly allocable to Federal awards on the basis of a beneficial or causal relationship between the expenses incurred and the agreements to which they are allocated in accordance with applicable requirements. Further, the same costs that have been treated as indirect costs have not been claimed as direct costs. Similar types of costs have been accounted for consistently and the Federal Government will be notified of any accounting changes that would affect the predetermined rate.

r declare that the foregoing is true and correct.
Governmental Unit:
Signature:
Name of Official:
Title:
Date of Execution:

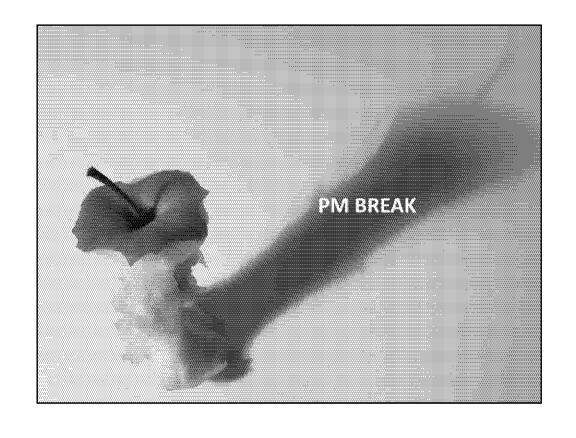
I declare that the foregoing is true and correct

#### E. Negotiation and Approval of Rates.

- 1. Indirect cost rates will be reviewed, negotiated, and approved by the cognizant Federal agency on a timely basis. Once a rate has been agreed upon, it will be accepted and used by all Federal agencies unless prohibited or limited by statute. Where a Federal funding agency has reason to believe that special operating factors affecting its awards necessitate special indirect cost rates, the funding agency will, prior to the time the rates are negotiated, notify the cognizant Federal agency.
- 2. The use of predetermined rates, if allowed, is encouraged where the cognizant agency has reasonable assurance based on past experience and reliable projection of the grantee agency's costs, that the rate is not likely to exceed a rate based on actual costs. Long-term agreements utilizing predetermined rates extending over two or more years are encouraged, where appropriate.
- 3. The results of each negotiation shall be formalized in a written agreement between the cognizant agency and the governmental unit. This agreement will be subject to re-opening if the agreement is subsequently found to violate a statute, or the information upon which the plan was negotiated is later found to be materially incomplete or inaccurate. The agreed upon rates shall be made available to all Federal agencies for their use.
- 4. Refunds shall be made if proposals are later found to have included costs that (a) are unallowable (i) as specified by law or regulation, (ii) as identified in Attachment B of this Circular, or (iii) by the terms and conditions of Federal awards, or (b) are unallowable because they are clearly not allocable to Federal awards. These adjustments or refunds will be made regardless of the type of rate negotiated (predetermined, final, fixed, or provisional).

#### F. Other Policies.

- 1. Fringe benefit rates. If overall fringe benefit rates are not approved for the governmental unit as part of the central service cost allocation plan, these rates will be reviewed, negotiated and approved for individual grantee agencies during the indirect cost negotiation process. In these cases, a proposed fringe benefit rate computation should accompany the indirect cost proposal. If fringe benefit rates are not used at the grantee agency level (i.e., the agency specifically identifies fringe benefit costs to individual employees), the governmental unit should so advise the cognizant agency.
- 2. Billed services provided by the grantee agency. In some cases, governmental units provide and bill for services similar to those covered by central service cost allocation plans (e.g., computer centers). Where this occurs, the governmental unit should be guided by the requirements in Attachment C relating to the development of billing rates and documentation requirements, and should advise the cognizant agency of any billed services. Reviews of these types of services (including reviews of costing/billing methodology, profits or losses, etc.) will be made on a case-by-case basis as warranted by the circumstances involved.
- 3. Indirect cost allocations not using rates. In certain situations, a governmental unit, because of the nature of its awards, may be required to develop a cost allocation plan that distributes indirect (and, in some cases, direct) costs to the specific funding sources. In these cases, a narrative cost allocation methodology should be developed, documented, maintained for audit, or submitted, as appropriate, to the cognizant agency for review, negotiation, and approval.
- 4. Appeals. If a dispute arises in a negotiation of an indirect cost rate (or other rate) between the cognizant agency and the governmental unit, the dispute shall be resolved in accordance with the appeals procedures of the cognizant agency.
- 5. Collection of unallowable costs and erroneous payments. Costs specifically identified as unallowable and charged to Federal awards either directly or indirectly will be refunded (including interest chargeable in accordance with applicable Federal agency regulations).
- 6. OMB assistance. To the extent that problems are encountered among the Federal agencies and/or governmental units in connection with the negotiation and approval process, OMB will lend assistance, as required, to resolve such problems in a timely manner.





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# Objectives for this Section: Cost Allocation Plan requirements per FTA Circular 5010.1D Cost allocation plan definitions, methods and applications Common weaknesses in transit industry Cost Allocation Plans

### Purpose/Benefit of Cost Allocation Plans/Indirect Cost Proposals

- Compute indirect cost rate(s)
- More accurate cost information
  - Identifies activities conducted by entity and associated costs
  - Identifies common support activities and functions they support
  - Identifies the costs of those activities/functions
  - Relates these costs to those other activities/ functions which they benefit
- More informed decision making


## Cost Allocation Plans Who Needs One? Transit agencies that wish to claim indirect cost reimbursement under federal grants and contracts **Exceptions:** Transit agencies that are capable of directly charging administrative costs to direct cost objectives Must be able to document direct allocations in all cost categories Must be consistent

### FTA Circular 5010.1D Indirect Cost Requirements

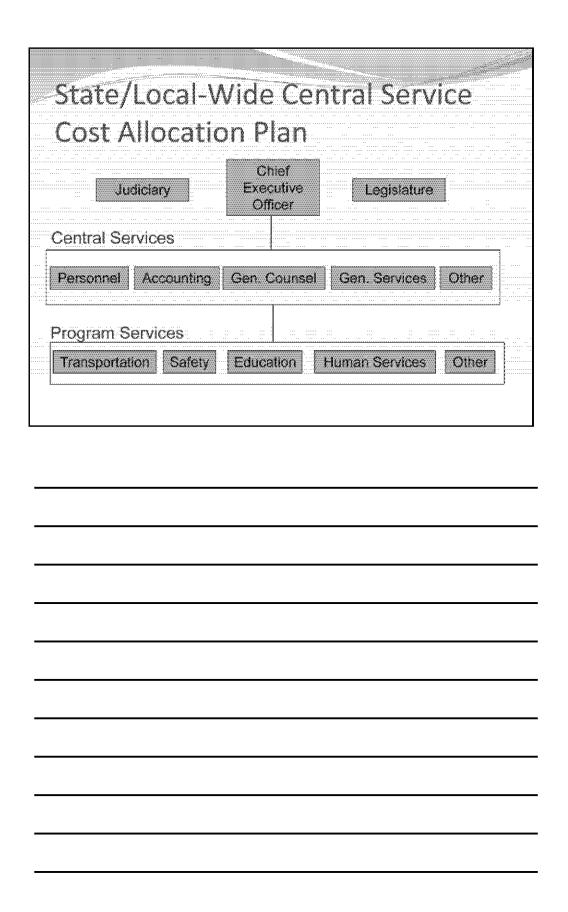
- Proposal must be updated annually
- Must be retained and made available for Single Audit review
- CAP must be adjusted to reflect actual costs
- Initial plan must be approved by FTA (cognizant agency)
- Costs in the plan must be supported by formal accounting records
  - Should cover all applicable costs, including costs of other agencies or units to be included in other federal programs
  - Should be presented in a single document

### FTA Circular 5010.1D Indirect Cost Requirements

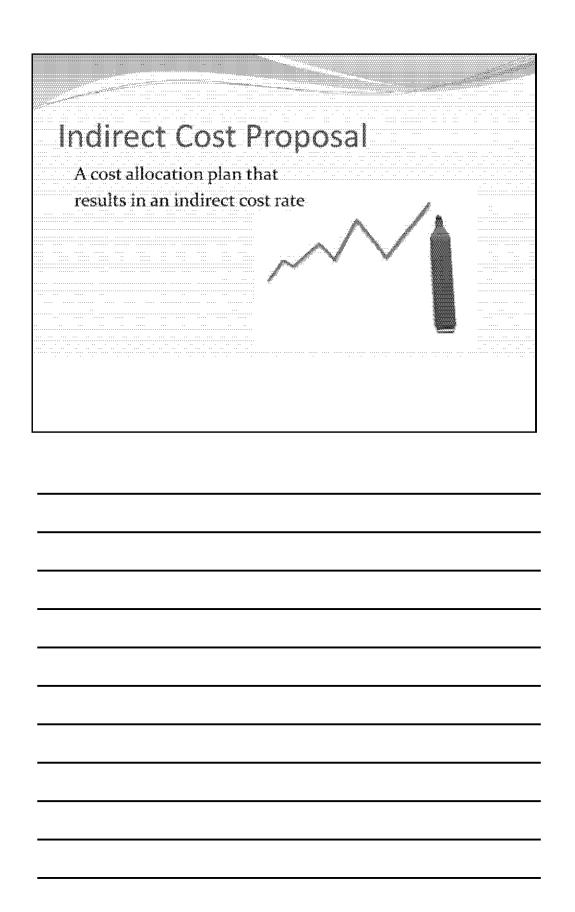
- Proposal must be approved by FTA, if:
  - First project or proposal
  - Accounting system changes
  - Proposed rate exceeds the amounts and rate approved for previous year(s) by more than 20%
  - Changes in CAP methodology

# **Cost Allocation Plans** Three Types: State/local-wide central services cost allocation plans Public Assistance cost allocation plans Indirect cost proposals – a cost allocation plan that results in indirect cost rates (A-87 Attachment E State and Local Indirect Cost Rate Proposals)

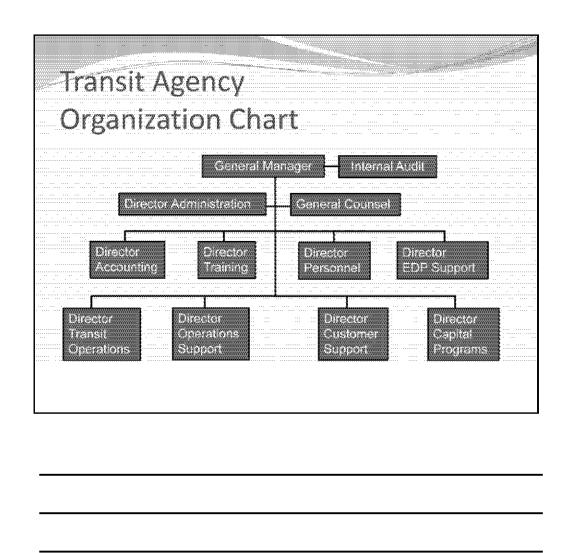
# State/Local Cost Allocation Plan \* A higher tiered allocation plan that identifies cost of supporting service units and allocates them to benefiting departments and agencies on an equitable basis Approved by the Division of Cost Allocation, DHHS



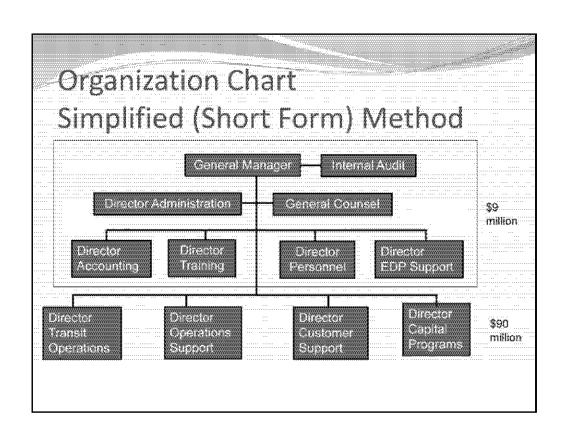
## Charging for Central Service Costs Billed central service costs (section II) ADP services safety \* telecommunications Allocated central service costs (section I) accounting budgeting payroll procurement



## What is an indirect cost rate? • The ratio expressed as a percentage of an indirect cost pool and some direct cost base Allowable Indirect costs = Indirect rate % Direct cost base Direct bases may be: Direct salaries and wages or a modification thereof Modified total direct costs (MTDC) i.e. Total costs less distorting costs



	icefx ixpx ixpx
Two Basic Methods for CAPs	
•Simplified Method	
Multiple Allocation Base	
	_

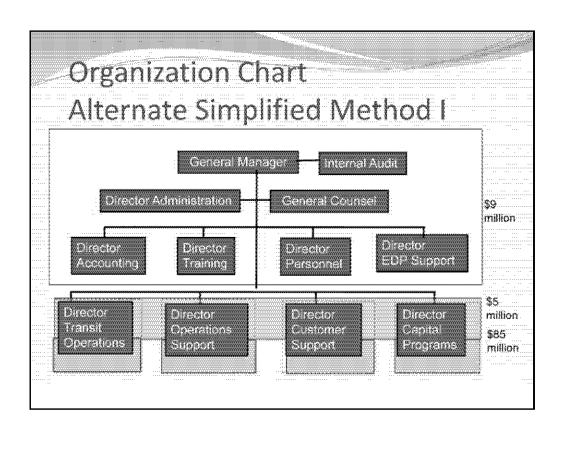


implified Method  Allowable TA Administrative Costs \$9,000,000  TA Direct Cost Base \$90,000,000
Agency Indirect Cost Rate = 10.0% *plus Central Service Allocations (if any)

# Simplified (Short Form) Method \* Pros: The least complex method Cons: Will result in a low rate because of the large base

# Alternate Simplified Method I Method recognizes departmental indirect costs Can be used: If ratio of indirect costs to the base approximates ratio at sister departments \* If not inequitable to the federal government

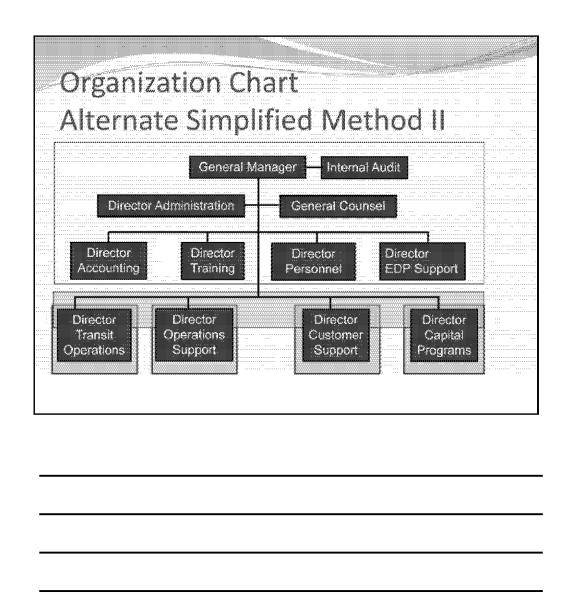
## Alternate Simplified Method I # Pros: Recognizes administrative costs of operating departments May recover more agency costs than other methods \* Cons: \* More difficult to prepare May result in less recovery than other methods

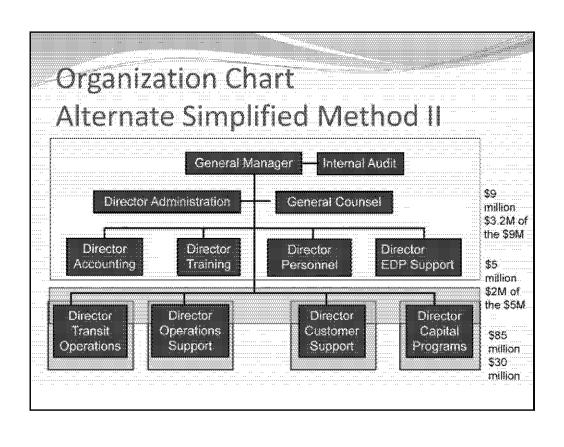


Administrative Costs	\$ 9,000,000
Division Level	
Administrative Costs	<u>\$ 5,000,000</u>
Total	\$14,000,000*
TA Direct Cost Base	\$85,000,000
Agency Indirect Cost	16.5%
Kate	
Rate	* Plus Central Service Allocations (if any)
Rate	
Rate	
Rate	
Tale	

### Alternate Simplified Method II Provides for divisional indirect cost rates Used when indirect effort at division level is significant and differs from sister divisions All agency and central service costs are allocated to the division on one allocation base \* Total indirect costs for a division will include agency indirects, division indirects and central services furnished to the agency

### Alternate Simplified Method II # Pros: \* Reflects administrative costs of individual operating divisions May recover more division level costs \* Cons: More difficult to prepare May result in lower recovery than other methods





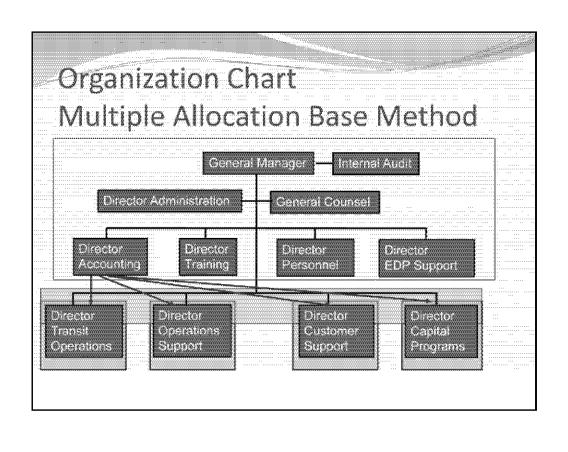
#### Alternate Simplified Method II Calculation of Agency Level Admin. Costs applicable to Capital Programs Division: 1. Total Agency Level Allowable Admin. Costs \$ 9 Million Total Agency Direct Costs 90 Million Agency Admin. Rate 10% 2. Capital Programs Division Costs: **Direct Cost** \$ 30 Million Division Allowable Admin. Cost \$ 2 Million **Total Division Costs** \$32 Million Agency Admin. Rate 10% \$ 3.2 Million Agency Admin. Costs Applicable to Division

Allocable Portion of TA Level	
Allowable Administrative Costs	\$ 3,200,000
Allowable Division	
Administrative Costs	<u>2,000,000</u>
Total	\$ 5,200,000
Division Direct  Cost Base	\$30,000,000
Division Indirect Cost Rate	17.3%

#### The Multiple Allocation Base Method

- Used when divisions do not use indirect costs to the same degree
- Allocates indirect costs to each division using multiple rate
- Result can be used as a management tool in determining costs of programs or divisions

## Multiple Allocation Base Method Pros: \* Theoretically most accurate May result in higher rate(s) \* Cons: Most complex Requires much more data May Result in Lower Rate



 ·	·	·	·	·	

Type of Service	Possible Allocation Base
Accounting	Number of transactions
Auditing	Audit hours
Budgeting services	Employee hours identifiable
Building lease management	Number of leases
Data processing	System usage (time)
Cash disbursements	Checks issued

	Allowable			Agenc	y Level Suppo	rl Costs			
Support Department	TA Indirect Costs	Admin	Accounting	Training	Personnel	EDP Supper	General Counsel	Internel Audit	Alocate Base
Ganarai aomin	1,545	(1.645)							Lobor \$
Ecual apportunity	395	(395)							tvo. of emp
Financial account	1,635		(1.636)						Labor \$
Жүффцефикений	167		(167)						· Lation 5
sudget and analy	969		(999)						Labor 5
Accounts payable	158		(158)						Latav \$
Safety & health	614			(814)					Labor \$
Staff development	723			(7,24)					Labor 5
Personet	532				(552)				. No. of eco
EOP support	1,577					(1,877)			System us
General counsel	246						(246)		No. of emg
miemal audif	200							(565)	anndit biocos
Agency-wide Indirect cost	9.433	(1.840)	(2.949)	(1.557)	(552)	(1.977)	1246)	(555)	
		·····	Vocation of Sup	pod Separta	ets wored (	xete to Operativo			
Operating Division		Admin	Accounting	Training	Personnel	SDP Support	General Counset	Internal Audil	
Transif Operation		1.141	1735	787	325	1.105	145	360	
Operations Support		571	857	393	162	552		125	
Customer Service		137	200	94	39	1.52	47	22	
Capital Programs		<b></b>	131	63	26	BÙ	12	56	
		1.040	2.040	4.227	560	5,599	346	222	

D-4-					od
	lculat	ion			
	I W WILLIAM	.1.32.33		Customer	Capital
	Total	Transit	Operations	Service	Programs
Administration	1,940	1,141	571	137	91
Accounting	2,949	1,735	867	208	139
Training	1,337	787	393	94	63
Personnel	552	325	162	39	26
EDP Support	1,877	1,105	552	132	88
General Counsel	246	145	72	17	1.2
Internal Audit	565	360	126	22	58 477
	9,466	5,598	2,742	649	477
Division IDC	31,470	15,210	13,680	1,080	1.500
	40,936	20,808	16,422	1,729	1,977
Total Direct					
Labor		50,000	25,000	6,000	4,000

#### Indirect Cost Proposal Documentation

- Organization chart
- Financial statements
  - Official approved budget
  - Audited statements
- Rate proposal with subsidiary worksheets and other relevant information
  - Description of each service/project and allocation base
  - Identification of units rendering and receiving service items of expense in cost distributions
  - \* Summary allocation schedule for each service/project

#### Indirect Cost Proposal Documentation

- Proposal reconciliation with financial statements
  - Reclassifications
  - Unallowable costs
- Federal award direct cost base salaries/fringes
- Certification of conformance with A-87
  - Cost are allocable, allowable, and consistency treated

# The Indirect Cost Rates Types Provisional/final \* Predetemined (i.e..., fixed) Fixed with carry forward

### Indirect Cost Rates Proposals **Timing and Support** Assume It is August 2009 (FY 10) ■ If need rate for FY 2009 Use 2009 costs with financial statements possibly with projections \* If need rate for FY 2010 Use 2010 costs with official budget

### Problems Found in Transit Agency Cost Allocation Plans

- Not reconciled to official budget or audited financial statements
- Non-federal and unallowable <u>direct</u> cost activities excluded from allocation bases
- Distorting direct costs not removed from bases
- Cost sharing not treated properly
- Unallowable costs not removed from indirect cost pools
- Inconsistent costing

#### Problems Found in Transit Agency Cost Allocation Plans

- Incorrect calculation and carry forward of variances
- Arithmetic errors
- Applicable rates not used in claims


# Summary **Cost Allocation Plans** Provide better information Can improve cash flows Guidance found in OMB Circular A-87, OMB Circular A-122, and FTA Circular 5010.1D Two basic methods