

PART 3 – COMPLIANCE REQUIREMENTS

INTRODUCTION

Overview

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

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

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

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

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

Use of Terminology in Part 3

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

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

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

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

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

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

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

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

COMPLIANCE REQUIREMENTS, AUDIT OBJECTIVES, AND SUGGESTED AUDIT PROCEDURES

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

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

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

Internal Control

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

Improper Payments

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

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

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

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

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

Organization and Use of Part 3 of the Supplement

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

A. ACTIVITIES ALLOWED OR UNALLOWED

Compliance Requirements

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

Source of Governing Requirements

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

Audit Objectives

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

Suggested Audit Procedures – Internal Control

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

Suggested Audit Procedures – Compliance

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

B. ALLOWABLE COSTS/COST PRINCIPLES

Applicability of Cost Principles

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

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

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

Source of Governing Requirements

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

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

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

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

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

Basic Guidelines

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

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

Selected Items of Cost

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

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

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

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

Selected Items of Cost - Exhibit 1

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

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

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

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

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

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

Suggested Internal Control Audit Procedures

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

Indirect Cost Rate

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

Audit Objectives – De Minimis Indirect Cost Rate

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

Suggested Compliance Audit Procedures – De Minimis Indirect Cost Rate

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

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

2 CFR PART 200

COST PRINCIPLES FOR STATES, LOCAL GOVERNMENTS, AND INDIAN TRIBES

Introduction

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

Cognizant Agency for Indirect Costs

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

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

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

Allowable Costs—Direct and Indirect Costs

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

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

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

1. Compliance Requirements – Direct Costs

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

2. Audit Objectives – Direct Costs

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

3. Suggested Compliance Audit Procedures – Direct Costs

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

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

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

1. Compliance Requirements – Indirect Costs

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

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

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

c. *Documentation and Certification Requirements*

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

2. **Audit Objectives – Indirect Costs**

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

3. Suggested Compliance Audit Procedures – Indirect Costs

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

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

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

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

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

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

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

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

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

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

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

a. Submission Requirements

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

b. Documentation Requirements

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

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

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

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

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

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

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

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

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

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

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

Allowable Costs – State Public Assistance Agency Costs

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

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

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

1. Compliance Requirements – State Public Assistance Agency Costs

a. Submission Requirements

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

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

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

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

2. Audit Objectives – State Public Assistance Agency Costs

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

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

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

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

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

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

2 CFR PART 200

COST PRINCIPLES FOR INSTITUTIONS OF HIGHER EDUCATION

Introduction

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

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

Cognizant Agency for Indirect Costs

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

Allowable Costs – Direct Costs

1. Compliance Requirements – Direct Costs

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

2. Audit Objectives – Direct Costs

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

3. Suggested Compliance Audit Procedures – Direct Costs

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

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

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

Allowable Costs – Indirect Costs

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

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

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

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

1. Compliance Requirements – Indirect Costs

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

2. Audit Objectives – Indirect Costs

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

3. Suggested Compliance Audit Procedures – Indirect Costs

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

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

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

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

- (g) Test the *operations and maintenance* cost pool to determine if:
 - (i) Costs are appropriately classified in this cost pool (2 CFR part 200, Appendix III, paragraph B.4).
 - (ii) Rental costs comply with the provisions of 2 CFR section 200.465.
 - (iii) The IHE's accounting practices for classifying
 - (A) rearrangement and alteration costs, and
 - (B) reconversion costs, either as direct or indirect, result in consistent treatment in like circumstances.
 - (iv) The allocation method for the operations and maintenance cost pool complies with 2 CFR part 200, Appendix III, paragraph B.4.
 - (v) If a utility cost adjustment has been included in the negotiated indirect cost rate, the adjustment complies with the provisions of 2 CFR part 200, Appendix III, paragraph B.4.c.

- (h) Test the *library* cost pool to determine if:
 - (i) Costs are appropriately classified in this cost pool (2 CFR part 200, Appendix III, paragraph B.8).
 - (ii) The allocation method for the library cost pool complies with 2 CFR part 200, Appendix III, paragraph B.8.
 - (iii) If the allocation method is based on a cost analysis study in accordance with 2 CFR part 200, Appendix III, paragraph A.2.d, determine that the study:
 - (A) Results in an equitable distribution of costs and represents the relative benefits derived;
 - (B) Is appropriately documented in sufficient detail for review by the cognizant agency for indirect costs;
 - (C) Is statistically sound;
 - (D) Is performed specifically at the educational institution;
 - (E) Is reviewed periodically, but not less frequently than rate negotiations, updated if necessary, and used; and

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

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

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

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

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

1. Compliance Requirements – CAS and Disclosure Statements

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

2. Audit Objectives – CAS and Disclosure Statements

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

3. Suggested Compliance Audit Procedures – CAS and Disclosure Statements

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

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

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

1. Compliance Requirements

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

2. Audit Objectives

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

3. Suggested Compliance Audit Procedures

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

2 CFR PART 200

COST PRINCIPLES FOR NONPROFIT ORGANIZATIONS

Introduction

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

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

Cognizant Agency for Indirect Costs

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

Allowable Costs – General Criteria – Direct Costs

1. Compliance Requirements – Direct Costs

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

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

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

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

2. Audit Objectives – Direct Costs

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

3. Suggested Compliance Audit Procedures – Direct Costs

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

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

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

Allowable Costs – Indirect Costs

1. Compliance Requirements – Indirect Costs

- a. Indirect costs are those that have been incurred for common or joint objectives and cannot be readily identified with a particular final cost objective. Direct costs of minor amounts may be treated as indirect costs under the conditions described in 2 CFR section 200.413(d). After direct costs have been determined and assigned directly to awards or other work, as appropriate, indirect costs are those remaining to be allocated to benefitting cost objectives. A cost may not be allocated to a federal award as an indirect cost if any other cost incurred for the same purpose, in like circumstances, has been assigned to a federal award as a direct cost. If an organization receives more than \$10 million in direct federal funding in a fiscal year, a breakout of the indirect cost component into two broad categories, Facilities and Administration, as defined in 2 CFR section 200.414(a), is required.
- b. Indirect cost rate proposals (ICRPs) are used to either establish predetermined rates, fixed rates with carry-forward provision, provisional, or final rates (2 CFR part 200, Appendix IV, paragraph C.1).
 - (1) *Predetermined rate* means an indirect cost rate, applicable to a specified current or future period, usually the organization's fiscal year. The rate is based on an estimate of the costs to be incurred during the period. A predetermined rate is not subject to adjustment.
 - (2) *Fixed rate* means an indirect cost rate which has the same characteristics as a predetermined rate, except that the difference between the estimated costs and the actual costs of the period covered by the rate is carried forward as an adjustment to the rate computation of a subsequent period.
 - (3) *Provisional rate or billing rate* means a temporary indirect cost rate applicable to a specified period which is used for funding, interim reimbursement, and reporting indirect costs on federal awards pending the establishment of a final rate for the period.
 - (4) *Final rate* means an indirect cost rate applicable to a specified past period which is based on the actual costs of the period. A final rate is not subject to adjustment.

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

2. Audit Objectives – Indirect Costs

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

3. Suggested Compliance Audit Procedures – Indirect Costs

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

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

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

1. Compliance Requirements – CAS and Disclosure Statements

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

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

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

2. Audit Objectives – CAS and Disclosure Statements

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

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

3. Suggested Compliance Audit Procedures – CAS and Disclosure Statements

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

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

1. Compliance Requirements

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

2. Audit Objectives

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

3. Suggested Compliance Audit Procedures

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

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

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