

# COPING WITH COST PRINCIPLES



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## Composition of Total Costs

■ Sum of:

$$\begin{array}{r} \text{Allowable direct costs} \\ + \\ \text{Allocable indirect costs} \\ - \\ \text{Applicable Credits} \end{array}$$

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## Factors Affecting Allowability of Costs

- a. Be reasonable for the performance of the award and be allocable, thereto, under these principles.
- b. Conform to any limitations or exclusions set forth in these principles or in the award as to types or amount of cost items.
- c. Be consistent with policies and procedures that apply uniformly to both federally-financed and other activities of the organization.

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## Factors Affecting Allowability of Costs

- d. Be accorded consistent treatment.
- e. Be determined in accordance with generally accepted accounting principles (GAAP).
- f. Not be included as a cost or used to meet cost sharing or matching requirements of any other federally-financed program in either the current or a prior period.
- g. Be adequately documented.

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## Reasonable Costs

Does not exceed that which would be incurred by a *prudent person* under the circumstances prevailing at the time.

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## Considerations for Determining Reasonable Costs

- a. The cost is of a type generally recognized as ordinary and necessary for the operation of the organization, or the performance of the award.
- b. The restraints or requirements imposed by such factors as generally accepted sound business practices, arms length bargaining, Federal and State laws and regulations, and terms and conditions of the award.

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## Considerations for Determining Reasonable Costs

- c. Whether the individuals concerned acted with prudence in the circumstances, considering their responsibilities to the organization, its members, employees, and clients, the public at large, and the Federal Government.
- d. Significant deviations from the established practices of the organization which may unjustifiably increase the award costs.

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## Allocable Costs

A cost is allocable to a particular cost objective, such as a grant, contract, project, service, or other activity, in accordance with the relative benefits received. A cost is allocable to a Federal award if it is treated consistently with other costs incurred for the same purpose in like circumstances and if it:

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## Allocable Costs

- (1) Is incurred specifically for the award.
- (2) Benefits both the award and other work and can be distributed in reasonable proportion to the benefits received, or
- (3) Is necessary to the overall operation of the organization, although a direct relationship to any particular cost objective cannot be shown.

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## Allocable Costs

Any cost allocable to a particular award or other cost objective under these principles may not be shifted to other Federal awards to overcome funding deficiencies, or to avoid restrictions imposed by law or by the terms of the award. (*Cost transfers between programs must be adequately documented.*)

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## Applicable Credits

Applicable credits refer to those receipts, or reduction of expenditures which operate to offset or reduce expense items that are allocable to awards as direct or indirect costs.

Shall be credited to the Federal Government either as a cost reduction or cash refund.

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## Applicable Credits

- Purchase discounts
- Rebates or allowances
- Recoveries or indemnities on losses
- Insurance refunds
- Adjustments of overpayments or erroneous charges

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## Questioned Costs

A cost that is questioned by the auditor because of an audit finding:

- (1) A violation or possible violation of a provision of a law, regulation, contract, grant, cooperative agreement, or other agreement or document governing the use of Federal funds, including funds used to match Federal funds;
- (2) The costs, at the time of the audit, are not supported by adequate documentation;
- (3) The costs incurred appear unreasonable and do not reflect the actions a prudent person would take in the circumstances.

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## Documentation is a Key to Avoiding Questioned Costs

- Underlying source documents should support the costs charged to federal programs. (Incorporate "memo-to-the file" when needed)
- Documentation should stand alone.
- Original documents are more reliable.
- Follow record retention standards (Generally 3 years, but some agencies require longer retention periods. Check your grant agreements.)

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## Reasons for Unallowable Costs

- Cost is unallowable.
- Cost is unreasonable in nature or amount.
- Proper approval was not obtained.
- Cost is not documented – this is the most common issue behind an unallowable cost.
- Unallowable costs are preventable.
- Maintain best evidence possible.
- Physical and documented statements can also be used as cost support.
- Memos-to-the-file to provide additional support for decisions that may cause question.

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## 1. Advertising and Public Relations

Advertising is allowable solely for:

- (1) The recruitment of personnel.
- (2) The procurement of goods and services.
- (3) The disposal of scrap or surplus materials.
- (4) Other specific purposes necessary to meet the requirements of the Federal award.

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## 1. Advertising and Public Relations

Allowable public relations costs:

- (1) Costs specifically required by the Federal award.
- (2) Costs of communicating with the public and press pertaining to specific activities or accomplishments which result from performance of Federal awards.
- (3) Costs of conducting general liaison with news media and government public relations officers.

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## 4. Audit Costs and Related Services

a. The costs of audits required by, and performed in accordance with, the Single Audit Act, as implemented by Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations" are allowable.

b. Other audit costs are allowable, if included in an indirect cost rate proposal, or if specifically approved by the awarding agency as a direct cost to an award.

c. The cost of agreed-upon procedures engagements to monitor subrecipients who are exempted from A-133 under Section 200(d) are allowable.

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## 8. Compensation for Personal Services

- Includes all compensation paid currently or accrued by the organization for services of employees rendered during the period of the award.
- Must be reasonable and conform to established policy, and be adequately documented.

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## Reasonable Compensation

Comparable to that paid for similar work in the labor markets in which the organization competes for the kind of employees involved.

Maximum annual salary for a Head Start employee cannot exceed Executive Level II, as established by the Office of Personnel Management (\$179,700 as of 1/1/10).

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## Other Costs Related to Compensation

- Fringe Benefits
- Organization Furnished Automobiles
- Pension Plan Costs
- Incentive Compensation
- Severance Pay

Remember to apply Agency policies consistently to all employees!

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## Support of Salaries and Wages

- Charges to awards for salaries and wages will be based on documented payrolls, and the distribution of salaries and wages to awards must be supported by personnel activity reports. (Documentation must support effort in the Federal program – the program's fair share.)
- Reports reflecting the distribution of activity of each employee must be maintained for all staff members. (Budgets do not support expenditures to a grant.)

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## Personnel Activity Reports

- Must reflect an after-the-fact determination of the actual activity of each employee.
- Must account for the total activity for which employees are compensated and which is required in fulfillment of their obligations to the organization.
- Must be signed by the individual employee, or by a responsible supervisory official having first hand knowledge of the activities performed by the employee.
- Must be prepared at least monthly and must coincide with one or more pay periods.
- Must include hours worked each day for nonprofessional employees (Fair Labor Standards Act).

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## 11. Depreciation and Use Allowance

- Compensation for the use of buildings and equipment may be made through use allowance or depreciation.
- Shall be based on acquisition cost, excluding the cost of land and any costs borne by the Federal Government, or as a matching requirement.

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## Depreciation

- Based on useful lives of the assets.
- Straight-line method is presumed to be the appropriate method.
- Building costs may be segregated by components.
- No depreciation on fully-depreciated assets.
- Depreciation records indicating the amount of depreciation taken each period must be maintained.

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## Use Allowance

- Building and improvements – 2%
- Equipment – 6.67%
- Must be supported by adequate property records, and physical inventories must be taken at least once every 2 years.

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## 15. Equipment and Other Capital Expenditures

(1) General purpose equipment, buildings, and land are unallowable as direct charges, except where approved in advance by the awarding agency.

(2) Special purpose equipment are allowable as direct costs, provided that items with a unit cost of \$5,000 or more have the prior approval of the awarding agency.

(3) Improvements to land, buildings, or equipment, which materially increase their value or useful life are unallowable as a direct cost, except with the prior approval of the awarding agency.

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## 15. Equipment and Other Capital Expenditures

(4) When approved as a direct charge, capital expenditures will be charged in the period in which the expenditure is incurred.

(5) Equipment and other capital expenditures are unallowable as indirect costs.

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## 29. Meetings and Conferences

Costs of meetings and conferences, the primary purpose of which is the dissemination of technical information, are allowable.

Includes costs of meals, transportation, rental of facilities, speakers' fees, and other items incidental to such meetings or conferences.

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## 30. Memberships, Subscriptions and Professional Activity Costs

### Allowable:

Membership in business, technical, or professional organizations.

Subscriptions to business, professional, or technical periodicals.

### Unallowable:

Membership in any country club, social, or dining club.

### Allowable with Prior Approval:

Membership in civic or community organization.

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### 36. Pre-Agreement Costs

- incurred prior to the effective date of the award.
- directly pursuant to the negotiation.
- in anticipation of the award.
- necessary to comply with the proposed delivery schedule or period of performance.

Allowable

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### 37. Professional Services

Costs of professional and consultant services rendered by persons who are members of a particular profession or possess a special skill, and ***who are not officers or employees of the non-profit organization***, are allowable.

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### 43. Rental Costs of Buildings and Equipment

- A. Allowable to the extent that rates are reasonable.
- B. "Sale and Leaseback" allowable up to the amount that would be allowed had the grantee continued to own the property.
- C. "Less-than-Arms Length" allowable up to the amount that would be allowed had grantee owned the property.
- D. Capital lease costs allowable only up to the amount that would have been allowable had the grantee purchased the property.

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## 47. Taxes

- Taxes which the grantee is required to pay are allowable with exceptions:
  - i. Taxes for which exemptions are available.
  - ii. Special assessment on land.
  - iii. Federal income taxes.

Tax refunds must be credited to the award that was charged or returned.

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## 49. Training

- In-house
- Part-time education
- Full-time education
- Executive or management training

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## 51. Travel

- Actual costs or per diem.
- Lodging and subsistence – cannot exceed charges normally allowed per written travel policy.
- Commercial air travel – standard commercial coach or equivalent class.
- Foreign travel – allowable with prior approval.

(Documentation includes the authorization to travel, expense statement with receipts, and adherence to Agency policy relative to per diems, etc.)

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# The Single Audit Process and How to Avoid Common Audit Problems



Understanding the Process and being Properly Prepared are the keys to a Successful Audit!

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## Avoiding Common Audit Problems

- Do you understand the audit process and how to interpret the results?
- Do you know the requirements of the auditee?
- Are you properly prepared for your audit?
- Is your agency in compliance with applicable laws and regulations? Do you know what compliance requirements you need to meet?
- Are your agency's internal controls adequate? Do they address compliance requirements for Federal Programs? Is documentation sufficient to support what controls are in place? Have you documented your agency's controls in accordance with the COSO framework?

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If you adequately address these issues and questions, your agency will be on track for a successful audit and will avoid common audit problems.

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## A Quality Audit is to Your Benefit!

- Avoid reputation risk in your community and amongst your peers.
- Fulfill your fiduciary responsibility.
- Meet the needs of your community.
- Provide assurance about the integrity of your programs.
- Be involved in quality assurance plan – identify any noncompliance or control weaknesses early.

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## What an Auditee can do to improve audit quality

- Be well educated about the single audit process.
- Know what is required of the auditee and understand your responsibilities in the audit process. **BE PREPARED!**
- Know the compliance requirements.
- Ensure your controls are documented and functioning as intended.
- Know the qualifications of your audit firm in the hiring process, and evaluate the audit firm's anticipated hours in relation to the firm's proposed audit fees.

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## Government Audit Quality Center of the American Institute of Certified Public Accountants

- Ask your auditor if they are a member of the GAQC.
- Ask about access to the archived conference call on *Preparing for Your Single Audit: An Auditee Perspective*.
- That call will address, in more detail, some of the topics we will go over today and provide additional insight to the audit preparation process.

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**THE PROCESS**

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**Overview of the Audit Process**

- Audit in Accordance with *Government Auditing Standards* - Higher Level of Standards
- Audit Covers Entire Agency
- Financial Statements are Presented Fairly in Accordance with GAAP or OCBOA
- Tests of Internal Control
- Tests of Compliance with Laws and Regulation
- Follow-up on Prior Year Audit Findings
- Submission of the Data Collection Form

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Understanding what reports will be issued as a result of the audit process and the Auditee's role and responsibilities.

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**REPORTING**

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**Audit Reporting**

- (1) An opinion as to whether the financial statements are presented fairly and an opinion as to whether the Schedule of Expenditures of Federal Awards (SEFA) is presented fairly in all material respects in relation to the financial statements taken as a whole.
- (2) A report on internal controls over financial reporting and compliance and other matters.
- (3) A report on compliance with major program requirements applicable to each major program.

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**AUDITEE RESPONSIBILITIES**

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## Auditee Responsibilities

- Prepare Schedule of Expenditures of Federal Awards – the SEFA and Auditee Section of the Data Collection Form. Provide a list of all Sub-recipient and Pass-through Entities. Determine all awards are properly identified by appropriate CFDA number, including ARRA Funds and Clusters. ([www.cfda.gov](http://www.cfda.gov) and Part 5 of 2009 Compliance Supplement Addendum #1)
- Assure that Compliance Documents are Organized and Available for Review. Compliance Staff Should be Available to Meet with Auditors.
- Internal Controls Should be Adequately Documented.
- Organize Financial Records and Reports.
- Document Status of Prior Findings.
- Organize Monitoring Files – site visits, A-133 reports, contracts, correspondence, and other cross-agency information.

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## Auditee Responsibilities (SEFA)

- (a) Identify, in its accounts, all Federal awards received and expended and the Federal Programs under which they were received. Federal program and award identification shall include, as applicable, the CFDA title and number, award number and year, name of the Federal agency, and name of the pass-through entity. (Remember to identify any new clusters and watch for new CFDA numbers due to ARRA funding.)

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## Schedule of Expenditures of Federal Awards

- (1) List individual Federal Programs by Federal agency.
- (2) For Federal awards received as a sub-recipient, the name of the pass-through entity and identifying number assigned by the pass-through entity shall be included.
- (3) Total Federal awards expended for each individual Federal Program and Cluster and the applicable CFDA number.
- (4) Notes that describe the significant accounting policies used in preparing the schedule.
- (5) Amount provided to sub-recipients from each Federal Program.
- (6) Federal awards expended in the form of non-cash assistance, the amount of insurance in effect during the year, and loans or loan guarantees.

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## Avoiding SEFA Errors

- Make sure you use proper CFDA #'s.
- Verify Cluster Programs in the Addendum to the March 2009 Compliance Supplement. (Part 5)
- Include all non-cash federal assistance.
- Reconcile expenditures to the general ledger – include only Federal portion of expenditures in the SEFA.

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## Auditee Responsibilities (IC)

- (b) Maintain internal control over Federal programs that provide reasonable assurance that the auditee is managing Federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its Federal programs.

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## INTERNAL CONTROL - COSO

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## Internal Control – Key Concepts

- It is a *process*. It is a means to an end, not an end itself.
- It is effected by *people*. It is not merely policy manuals and forms, but people at every level of an organization.
- It can be expected to provide only *reasonable assurance*, not absolute assurance, to an entity's management and board.
- It is geared to the achievement of *objectives* in one or more separate, but overlapping categories.

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## Internal Control – The COSO Framework

THE CONTROL ENVIRONMENT – establishes the foundation.  
(Tone at the Top)

RISK ASSESSMENT – identification and analysis by management of relevant risks. (i.e. risk of material misstatement of financial statement amounts, or risk of material noncompliance)

CONTROL ACTIVITIES – policies, procedures, and practices.  
(Your response to the risk assessment)

INFORMATION AND COMMUNICATION – supports all other control components. (How information flows through your organization)

MONITORING – oversight of internal controls.

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## Evaluate Your Control Structure Under COSO

- What is management's attitude about controls? - the control environment.
- How do you know you needed this control? – the risk assessment process.
- What is your response to your identified risks?: proper segregation duties, safeguarding of assets, timeliness of recording transactions – control activities.
- How do you communicate the control process? – information and communication.
- How do you know the control is functioning properly? – the monitoring process.

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## Document Your Controls Using COSO

- Make sure everyone in the organization knows the controls and where they are documented.
- Provide employee training.
- Review controls to determine they are functioning as designed.
- Monitor employees for compliance with the control structure – establish internal quality control processes.

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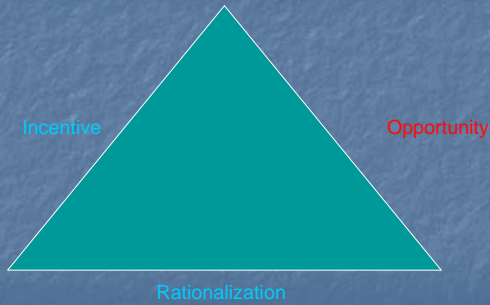
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## Fraud Awareness



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## COMPLIANCE

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## Auditee Responsibilities

- (c) Comply with laws, regulations, and the provisions of contracts or grant agreements related to each of its Federal programs. As stated in Part 6 – Internal Control of the 2009 A-133 Compliance Supplement, “The A-102 Common Rule and OMB Circular A-110 require that non-federal entities receiving federal awards establish and maintain internal controls designed to reasonably ensure compliance with Federal laws, regulations, and program compliance requirements.”

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## Know Your Compliance Requirements

- Review A-133 Compliance Supplement.
- Review Your Grant Documents and Contracts.
- Establish Controls to Ensure Compliance with These Requirements.

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## Internal Control Objectives Regarding Compliance Requirements for Federal Programs

- Transactions are properly recorded and accounted for.
- Transactions are executed in compliance with laws and regulations.
- Funds and other assets are properly safeguarded from unauthorized use.



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## Compliance

- A. ACTIVITIES ALLOWED OR UNALLOWED
- B. ALLOWABLE COSTS/COST PRINCIPLES
- C. CASH MANAGEMENT
- D. DAVIS-BACON ACT
- E. ELIGIBILITY
- F. EQUIPMENT AND REAL PROPERTY MANAGEMENT
- G. MATCHING, LEVEL OF EFFORT, EARMARKING

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## Compliance

- H. PERIOD OF AVAILABILITY OF FEDERAL FUNDS
- I. PROCUREMENT AND SUSPENSION AND DEBARMENT
- J. PROGRAM INCOME
- K. REAL PROPERTY ACQUISITION AND RELOCATION ASSISTANCE
- L. REPORTING
- M. SUBRECIPIENT MONITORING
- N. SPECIAL TESTS AND PROVISIONS

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## Auditee Responsibilities

- (d) Prepare appropriate financial statements, including the Schedule of Expenditures of Federal Awards in accordance with §.310.

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## Auditee Responsibilities

- (e) Ensure that the audits required by this part are properly performed and submitted when due. **No extension will be given for A-133 audits effective immediately. Filing late will affect low risk auditee assessment by your auditor for subsequent year's audit.**
- (Auditor Procurement - Factors to be considered in evaluating each proposal for audit services include the responsiveness to the request for proposal, relevant experience with community action agencies, availability of staff with professional qualifications and technical abilities, the results of external quality control reviews, and price.)

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## Agency Responsibilities

- (f) Follow up and take corrective action on audit findings, including preparation of a summary schedule of prior audit findings and a corrective action plan in accordance with **§.315(b)** and **§.315(c)**, respectively. **Address the findings in a manner that can be carried out. Don't make promises you can't keep! Avoid a repeat finding in the subsequent audit period.**

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BEING PREPARED – Steps to follow throughout the year, as well as at year end.



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## Preparing for a Successful Audit Takes all Year!!

Keep these steps in mind:

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## Cost Allocations and Time Report



- Organize all cost allocation materials, including allocation support such as time studies and square footage. Documentation support is key!
- Employee time reports.

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## File Timely and Accurate Financial and Performance Reports - this includes 1512 Reports under ARRA.

Late reports can indicate weaknesses in your grant management system. (2010 Compliance supplement to address specific testing by the auditors of 1512 Reporting.)

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## Year End Transfers

Shifting of costs between programs may cause suspicion, particularly those at year end. Maintain proper support and authorization for all transfers between programs.

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## Apply Applicable Credits to Grants

- Purchase discounts
- Rebates
- Refunds
- Contract settlements
- Returns

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## Cash Management

- Efficient use of cash and minimization of time between draws.
- Documentation to support cash draws.
- Credit of interest earned by Federal funds.

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## Updated Property and Depreciation Records

- All property records should include information required by A-102 or A-110. Update records for all additions, deletions, and current year depreciation charges.
- Inventory all equipment, especially equipment purchased with Federal funds at least once every 2 years.
- Reconcile inventory records to property records and general ledger.

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## Documentation of In-kind Contributions



- Maintain adequate support for fair market value estimates for contributions of supplies, services, equipment, and facilities used for matching or cost sharing purposes. There have been cases of in-kind being disallowed due to inadequate support. If you lose in-kind match funds, you may be asked to return grant funds.

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## Subsidiary Record Support

Reconcile all subsidiary information on a monthly basis to general ledger amounts.

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## YEAR END AUDIT PREPARATION



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## Audit Prep List – Initial Year

- By-laws
- Articles of Incorporation
- IRS Determination Letter
- Cost Allocation Plan
- Chart of Accounts
- All relevant policies:
  - Personnel
  - Fiscal
  - Other
- Description of critical internal control activities

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## Audit Prep List – Background Items

- Document/Update Internal Control
- Monitoring Reports from grantors or oversight agencies
- Minutes of Board and Committee meetings
- List of Board of Directors
- Transactions with Board Members or other related parties
- All significant contracts and grant agreements affecting the audit year

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## Audit Prep List - Financial

- General Ledger Detail
- Revenue and Expense reports by grants, funds, or contracts
- Subsidiary journals:
  - Receipts
  - Disbursements
  - Payroll
- Financial Statements, including Schedule of Expenditures of Federal Awards
- Trial Balance at audit date
- Budget, (original and final revised) for the year

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## Audit Prep List – Asset Support

- Bank Reconciliations at audit date, including listing of outstanding checks (all accounts)
- Bank statements and canceled checks or check images
- Trustee or brokerage statements for any investment accounts
- Details of all securities transactions
- Detailed listing of receivables
- Detailed fixed asset schedule, reconciled to general ledger, including depreciation calculation, additions, and deletions for the year
- Prepaid expense schedule
- Schedule of deposits and other assets

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## Audit Prep List – Liability Support

- Detailed listing of accounts payable by vendor
- Details of any deferred (unearned) revenue
- Detail of accrued payroll or other expenses
- Detail of accrued vacation by employee, including rate of pay and hours accrued
- Details of any loans payable including amount due, name and address of lender, interest rate, maturity date, last date interest paid
- Schedule of unpaid payroll tax and other payroll withholdings

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## Audit Prep List - Other

- List any litigation pending or significant commitments.
- Provide copies of insurance coverage.
- Provide 941 Forms and related payroll tax returns for the year.
- Provide access to personnel files, including rate of pay authorization.
- Prepare confirmations as requested:
  - Bank accounts
  - Loans
  - Receivables
  - Grant and contract revenue

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## Audit Prep List – Net Asset Support

- Schedule of any transfers between net asset classifications.
- Information related to any temporarily or permanently restricted contributions.

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## Get the Most From Your Audit

- Make sure the audit firm has quality, knowledgeable staff with the right skills for your audit.
- Grant your auditor access to all the necessary financial and program records and be sure to identify all governmental financial assistance and federal programs in which you participate.
- Ensure that your key staff persons are available to your auditor.
- Be actively involved – take the initiative to understand what your auditor is doing and ask questions when you don't.
- Ask questions about your auditor's work, the audit opinion, and other compliance reports.

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## AMERICAN RECOVERY AND REINVESTMENT ACT - ARRA

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## Impact of Recovery Act on the Audit Process



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## Recovery Act

- Some June 30, 2009, impact, mostly at state level.
- Larger impact on 2010 and 2011 audits.
- Change to major program selection, specifically dealing with new program clusters.
- Compliance supplement will be continuously changing – 2009 issued; 2010 in draft as of May 2010.
- Monitor ongoing changes and updates, specifically those impacting compliance.

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## ACCOUNTABILITY AND TRANSPARENCY ARE KEY ISSUES

- Greater interest in A-133 audits.
- Chances for review of audits are significantly higher.
- Push to get audits done quicker – no change in 9-month reporting as of yet. However, no extensions to be given!
- Quicker resolution of findings.
- New board to monitoring ARRA activity, including fraud, waste, and abuse: Recovery Act Transparency Board (RATB).

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## Establish Your Process For Compliance Early and Monitor That Process

- Agencies process for accepting Recovery Act funds.
- Segregate recovery funds.
- Appoint appropriate level of management to oversee the Recovery Act funds and requirements.
- Educate employees on new requirements and continuous updates.
- Fine tune your reporting process – significant impact by Section 1512 reporting.
- Evaluate controls processes to assure they are working properly and consider if additional controls are necessary.
- Determine monitoring process is in place, if you plan to pass through any Recovery Act funds to a sub-recipient.
- Properly identify all ARRA funding on your SEFA.

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## Questions



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THANK YOU FOR YOUR  
PARTICIPATION TODAY. ANY  
QUESTIONS MAY BE  
FORWARDED TO:

Mike A. Zeno, CPA – [mzeno@srsnodgrass.com](mailto:mzeno@srsnodgrass.com)  
Mary C. Pockl, CPA – [mpockl@srsnodgrass.com](mailto:mpockl@srsnodgrass.com)

Stay tuned for Part II on Allowable Costs!

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