

Grant Administrator's Guide to Preparing for an A-133 Audit of Sponsored Projects: *The Responsible Stewardship of Federal Funds as Preparation for the A-133 Audit*

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Abstract

The receipt of federal funds is a responsibility that requires diligent stewardship. Accountability for the use of these funds is not limited to the closeout period of the award but is an ongoing activity that lasts the entire life of the award. Accounting for federal awards is not simply an exercise in getting an account to balance; it is the guardianship of a public trust. Answerability for the use of these funds must be taken into consideration in every phase of the award cycle. In an attempt to ensure that federal fund recipients are managing their awards in a fiscally responsible and compliant manner, the Single Audit Act of 1984 was passed, followed by the Single Audit Act Amendments of 1996 (31 U.S.C. Chapter 75). The Office of Management and Budget (OMB) issued Circular A-133 in 1990 to extend the single audit requirements to nonprofit organizations to implement the 1996 amendments and make all grantees subject to its requirement. Circular A-133 (68 Fed. Reg. 38401) was amended on June 27, 2003 (62 Fed. Reg. 35278). This paper will give a brief overview of the requirements of OMB Circular A-133 and help recipients prepare for the A-133 audit.

Introduction

Organizations that expend \$500,000 (for fiscal years ending after 31 December 2003 - \$300,000 prior to that date) or more in federal funds either as a prime recipient, subrecipient or both during their fiscal year must have a single audit (or a program specific audit if the criteria for a program specific audit is met and is more applicable) in accordance with OMB Circular A-133 as amended on June 27, 2003 and the Single Audit Act Amendments of 1996. The A-133 audit must be done in accordance with Government Auditing Standards (GAS) and cover the entire operation of the auditee (Financial Statements and Schedule of Expenditures of Federal awards). It is permissible to have a series of audits that are department specific, organizational unit specific, etc, but each audit must review the Financial Statements and Schedule of Federal Expenditures for each unit. The audit process analyzes and examines the financial and award specific requirements of the recipient and how they interrelate with each other and with sponsored projects.

Preparation for the annual audit should not begin a month or two before the auditor's scheduled visit, it should begin the moment an award arrives at the institution and should last until the final closeout procedures are completed. In other words, it should be an ongoing, daily process, which requires diligence, organization and attention to detail. Processes, policies and controls need to be developed, reviewed and followed.

A system of checks and balances should be in place, and a strong sense of teamwork among all the parties involved in the audit process is essential. If approached correctly, the A-133 audit should be a constructive activity, which reviews institutional processes, reaffirms that institutional oversight is appropriate, suggests improvements to institutional procedures and confirms the benefits of the institutional procedures to both the recipient and the sponsor. The audit process should be an evaluation and an intellectual exchange of ideas and not an adversarial process that is dreaded and feared. To achieve this goal, those involved in administering federal awards must be familiar with the laws, rules and regulations, terms and conditions governing these awards and must be familiar with the policies and practices surrounding the A-133 audit.

The A-133 Audit

What is an A-133 audit?

Audits performed in accordance with OMB Circular A-133 are conducted using the generally accepted government auditing standards and are financial as well as administrative audits. They are not performance audits. (Federal agency audit personnel conduct performance audits). The purpose (NACUBO and NCURA, *Managing Federal Grants for Colleges and Universities*, pg. 2300:71) of the A-133 audit is to:

- Establish compliance with applicable laws, regulations, rules and award conditions;
- Ensure that the institution can adequately demonstrate compliance with applicable laws, regulations, rules and award conditions;
- Assess the institution's internal controls and determine if they are sufficient to reasonably ensure that federal funds and property are safeguarded and that financial reporting is accurate;
- Make sure that the financial statements are presented fairly and accurately and are in accordance with generally accepted accounting principles (GAAP).
- Confirm that the Schedule of Expenditures and Federal awards is fairly presented in all material aspects in relation to the financial statements.

Preparing for the A-133 Audit

Although OMB Circular A-133 does not have specific requirements for audit planning, the auditee should: (1) know and understand the audit requirements; (2) identify and prepare the resources that will need to be made available to the auditor; and (3) notify the cognizant agency. The best way to prepare for the A-133 audit is to be knowledgeable – of the laws, the rules, the regulations, the terms and conditions of the award (s) - to be ever vigilant and to always be aware. Pinpointing and anticipating possible problem areas is more desirable than having to deal with them after the fact (during an audit). The Office of the Inspector General has audit guides available, and it is worthwhile to have one available at your institution, especially for new staff to review.

An appropriate institutional audit policy should be put in place and should be made available to all the parties involved in the A-133 audit. The policy should designate the institutional contact person and the procedure that should be followed for providing the auditors with the required records and schedules.

The designated institutional contact should work with the auditors to schedule the timing of the audit, attain the scope of the audit (in order to adequately prepare required schedules and information), keep the lines of communication open during the audit and work with institutional staff to provide appropriate workspace for the auditors. An exit interview should be arranged to discuss the preliminary findings of the audit and to clear up any misconceptions or erroneous information, and a procedure for audit review and response should be in place.

It is the responsibility of the grantee to identify all federal awards and associated programs by CFDA title and number, award number, budget period, name of federal awarding agency and name of pass-through entity. The subrecipient on a federal award should receive this information for their particular award.

Always document! Documentation of expenditures is crucial. Grant recipients are required to maintain records of the financial and programmatic elements of an award. Lack of documentation can be construed as an indication that the institution's controls are below par. It is never wise to rely on a memory of the whys and wherefores of a transaction – people change and memories fail. Documentation illustrates a transaction was reviewed before it occurred and can often answer a question before it becomes an audit issue. Remember – *the burden of proof of compliance rests with the grantee!*

At IES there are currently over 200 open awards, 50 subcontracts and sponsored project expenditures in excess of \$5.7M. In preparation for our A-133, I assemble an audit book, which contains new award notifications, a subcontract payment schedule, a copy of our facilities and administration (F&A) rate proposal and approval, a list of all institutions (and contact names) that are required to give us A-133 notification, a list of all institutions (and contact names) that we notify upon completion of our A-133 audit, a monthly facilities and administration (F&A) rate analysis (which tests that the appropriate F&A rate is being applied correctly to each account. This is especially important since we use an effective rate which consists of a blended onsite/offsite rate), a monthly fringe benefit rate analysis and any other information that may be applicable. Our auditor finds this book very helpful, and it allows me to prepare the necessary information over the year rather than in a short, hurried time span. It also gives me time to review for compliance and spot any potential problem areas. In addition, it serves to illustrate how seriously we view the A-133 audit and the depth of our attention to detail.

Elements of the A-133 Audit

An A-133 audit reviews the institution's compliance with federal program requirements and related audit objectives as well as the institution's financial statements. Some of the elements that may be tested are (Grants Management Advisory Service, *Federal Grants Management Handbook*, Tab 450 pg. 15):

- Allowable/unallowable costs;
- Funds expended in the available period of time;
- Subrecipient monitoring;
- Reporting – financial and programmatic – to ensure that they are completed on time;
- Grant activities that are allowed/unallowed;
- Property acquisition and management;

- Equipment management;
- Procurement;
- Suspension and Debarment and Conflicts of Interest;
- Program Income;
- Eligibility;
- Cash Management;
- Davis-Bacon Act, Drug Free Workplace Act, Hatch Act, civil rights requirements;
- Level of effort, matching and earmarking;
- Special tests and provisions.

During the A-133 audit, auditors are looking for any reportable conditions (weaknesses) in the institution's internal control over federal funds, material non-compliance with the terms and conditions or regulations and laws related to federal contracts or grant agreements, and questionable costs and fraud. Exclusion from testing an element for noncompliance is based on its material (or immaterial) effect on the federal program or the auditor's conclusion that the requirement does not apply to the program. For example: Disregarding institutional policies and treating each award in a different manner would be considered to have a material effect if it results in increased cost to the project without measurable benefit or justification. If it is the policy of the institution to reimburse travel expenses on the basis of actual costs (with receipt backup for expenses exceeding a specified dollar amount), you should not permit per diem expense reimbursement on one award because the traveler could not find the necessary receipts to submit for reimbursement.

Passing the Transaction Test

The elements the auditor looks at when testing transactions are – *prudence, allocation and reasonableness*. The amount of the expense should be *reasonable*, the institutional procedures should be *prudent* and the cost should be *allocable*. (Grants Management Advisory Service, *Federal Grants Management Handbook*, Tab 450 pg. 15).

The criteria for reasonableness, prudence and allocable costing include:

- Expense should be ordinary and necessary to both the organization and the award;
- Expense should not exceed market cost for similar services or goods;
- Expense is prudent when taking into consideration both circumstance and federal responsibility;
- Costs should be consistently treated in accordance with the institution's policies and procedures. Costs incurred for the same purpose, in like circumstances, should be consistently treated as either direct or indirect costs. (Direct costs are clearly identifiable to a specific project; indirect costs are common to a number of projects and cannot be clearly allocated to one);
- A *significant* deviation from established practices and policies that causes increased cost to the award with no identifiable justification may be considered unreasonable.
- Accurate and consistent accounting processes are utilized.

Each transaction should have a well-documented audit trail that includes authorization for expenditure, backup documentation and allocation of expenditure. Expenses on federal awards should be treated consistently with non-federal expenses, should directly relate to the project to which it is being charged and should always be in line with institutional policies and procedures.

Internal Controls

An important focus of the A-133 audit is the internal controls of the organization. Some of the areas that the auditor will be testing are: integrity of financial data, transaction authorization, accuracy and completeness of data input, data access restriction, consistent treatment, adherence to policies and procedures, and oversight of expenditure transactions.

Some items require close monitoring because improper handling could cause audit findings for the institution. These include: changing the scope of the project without sponsor approval, expenses deemed unallowable by either OMB Circular A-122 or A-21, improper transaction authorization, changing principal investigator without prior approval, incorrect effort reporting, charges for foreign travel without sponsor approval (unless specifically permitted in the program guidelines), improper handling of program income, the addition of subcontracts without following agency procedures, incurring costs after termination of the award, major purchases of equipment at the end of an award without a compelling reason, overcharge transfers and charging unrelated projects costs to an award.

Another potential problem area is the tracking of cost sharing (or matching). Cost sharing can either be mandatory or voluntary. In either case it is important to maintain good tracking records of all cost sharing required by a particular award. I recommend that each cost sharing obligation be set up as a separate account, that clearly indicates which grant award it is for, so that the cost sharing can be carefully monitored. The reason for this is twofold: (1) if asked to report on the cost sharing, the information will be readily available and (2) it can be monitored to ensure that the cost sharing requirements are being met.

A good internal control system should have sufficient checks and balances in place to catch a potential problem. Always exercise due diligence when approving expenditures charged to a specific award or project.

Determining Risk Level

OMB Circular A-133 §.525 gives the criteria used for determining an organization's risk level. Risk level is based on the auditor's evaluation of likelihood of non-compliance occurring within an organization that could have a material effect on a federal program. Some of the elements that are considered when determining risk are:

- Current and prior audit experience – (1) any weakness in internal controls, (2) prior audit findings, (3) inherent risk of the program.

The criteria that OMB Circular A-133 §.530 states should be used to determine low risk are: (1) Single audits were performed on an annual basis; (2) the auditor's opinion on the financial statements and schedule of expenditures of Federal awards was unqualified;

(3) no deficiencies were found in internal control; (4) there were no Federal award audit finding for two preceding audits.

Reporting Package

Copies of the audit reports need to be submitted to the Single Audit Clearinghouse within thirty days of receiving the report or nine months after the audit period ends (whichever is earlier). Enough copies of the reporting package should be sent so that the Clearinghouse can distribute them to as many federal agencies as necessary. The report package includes:

- Financial Statements (must reflect the institution's financial position, the results of its operation or any changes in its net assets or cash flow) and Schedule of Federal Expenditures (must cover the same period as the financial statements, show and identify total federal awards expended, identify subrecipient and pass through entities and relevant identifying information).
- Completed Data Collection Form (gives a summary of the single audit and identifies the federal agency(s) that should receive a copy of the reporting package. A copy is available at <http://harvester.census.gov/sac>)
- Summary Schedule of Prior Audit Findings
- Corrective Action Plan (See Appendix A), if necessary
- Auditor's reports (opinions of internal controls, financial statements, schedules, questioned costs).

Subrecipients *must* provide a copy of the reporting package to pass-through entity if there are any audit findings related to any of the federal awards provided by the pass-through entity. The subrecipient is required to notify the pass-through entity that an audit was conducted in accordance with OMB Circular A-133 (unless it does not apply), identify the awards received from the pass-through entity, and state that there were no audit findings. However, if a federal agency or a pass-through agency requests a copy of the reporting package, the subrecipient is obligated to send it to them.

*(See OMB Circular A-133 §_.320 (c) (e) (1)) Subrecipients shall submit to each pass-through entity one copy of the reporting packagewhen the schedule of findings and questioned costs disclosed audit findings relating the Federal awards that the pass-through entity provided.....(2)....the subrecipient shall provide written notification to the pass-through entity that: an audit of the subrecipient was conducted in accordance with this part.....; the schedule of findings and questioned costs disclosed no audit findings related to the Federal award(s) that the pass-through entity provided; and, the summary schedule of prior audit findings did not report on the status of any audit findings relating to the Federal award(s) that the pass-through entity provided.....(f) **In response to requests by a Federal agency or pass-through entity, auditees shall submit the appropriate copies of the reporting package.....**)*

2004 Compliance Supplement to OMB Circular A-133

The Office of Management and Budget is planning to rewrite the *A-133 Compliance Supplement* and is scheduled to release it in late April 2004. This supplement will provide guidance for the testing of compliance with cost principal circulars to ensure that recipients have met the cost principals and allowable cost requirements that relate to their type of organization.

In this 2004 Compliance Supplement, OMB is attempting to increase guidance on cost principals and will probably rewrite Part 3, Item B to clarify the relationship the Cost Principal Circulars (A21, A122, A87) and the Administrative Requirements Circulars - OMB Circulars A110 (for institutions of higher education, hospitals and other nonprofit organizations) and A102, the common rule (states and local governments). The Office of Management and Budget plans to provide additional guidance and clarification for reviewing direct and indirect costs and special compliance requirements.

Conclusion

As a recipient of federal funds, it is necessary to exercise care and vigilance over its use. The A-133 audit is the 'checks and balance' review that ensures federal funding recipients are safeguarding the assets that have been entrusted to their care. It is a sobering responsibility and should not be taken lightly. The important elements to keep in mind are: consistency, accountability, reasonableness, prudence, knowledge, awareness and compliance. Preparation for the A-133 audit should be an every day, ongoing process and not one that is relegated to a short time period every year.

Appendix A

Some relevant definitions of terms included in the Single Audit Act (31 U.S. C. §§7501-7507) Single Audit Act Amendments of 1966 (P.L. 104-156) (Thompson Publishing Group, *Single Audit Information Service*, Vol. 1, pgs 39-41. Washington, D.C., 1997)

Federal award – federal financial assistance and federal cost reimbursement contracts that non-federal entities receive directly from federal awarding agencies or indirectly from pass-through agencies.

Federal financial assistance – assistance that non-federal entities receive of administer in the form of grants, loans, loan guarantees, property, cooperative agreements, interest subsidies, insurance, food commodities, direct appropriations or other assistance, but does not include amounts received as reimbursement for services rendered to individuals in accordance with guidance issued by the director (of the Office of Management and Budget – OMB).

Federal program – all federal awards to a non-federal entity assigned to a single number in the *Catalog of Federal Domestic Assistance* (CFDA #) or encompassed in a group of numbers or other category as defined by the director².

Generally accepted government-auditing standards (GAGAS) – auditing standards issued by the Comptroller General of the United States.

Independent auditor – (1) external state or local government auditor who meets the independence standards included in *Government Auditing Standards* or (2) a public accountant who meets such independence standards.

Internal Controls – a process, affected by an organization’s management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- Effectiveness and efficiency of operations.
- Reliability of financial reporting.
- Compliance with applicable laws and regulations.

Major program – federal program identified in accordance with risk-based criteria prescribed by the director (of OMB) under the Single Audit Act Amendments of 1996, subject to the limitations described under subsection (b) of the 1996 amendments.

Non-profit entity – state, local government or non-profit organization.

Non-profit organization – any corporation, trust, association, cooperative or other organization that (1) is operated primarily for scientific, education, service, charitable or similar purposes in the public interest, (2) is not organized primarily for profit, and (3) uses net proceeds to maintain, improve or expand the operations of the organization.

Pass-through entity – a non-federal entity that provides federal funds to a subrecipient to carry out a federal program.

Program-specific audit – an audit of one federal program.

Recipient – a non-federal entity that receives awards directly from a federal agency to carry out a federal program.

Single audit – an audit (described under 31 U.S.C. §7502 (d), of a non-federal entity that includes the financial statements and federal awards.

Subrecipient – non-federal entity that receives federal awards through another non-federal entity to carry out a federal program but does not include an individual who receives assistance through such awards.

Internal control pertaining to the compliance requirements for federal programs (Internal control over federal programs) – process, effected by an entity’s management and other personnel to provide reasonable assurance regarding the achievement of the following objectives:

- Transactions are properly recorded and accounted for to (a) permit the preparation of reliable financial statements and federal reports, (b) maintain accountability over assets and (c) demonstrate compliance with laws, regulations and other compliance issues;
- Transactions are executed in compliance with (a) laws, regulations and the provisions of contracts or grant agreements that could have a direct material effect on a federal program and (b) any other laws and regulations that are identified in the compliance supplements; and
- Funds, property and other assets are safeguarded against loss from unauthorized use or disposition.

Management decision – evaluation by the federal awarding agency, public auditor or pass-through entity of the audit findings and corrective action plan and the issuance of a written decision as to what corrective action is necessary.

Additional definitions:

Audit risk – risk that the auditor can issue an unqualified or “clean” opinion on the organization’s financial statements.

Cognizant agency – is assigned to federal award recipients that spend over \$50 million a year in federal awards. (Not to be confused with the cognizant agency for Facilities and Administration agreements and cost allocation plans for federal award recipients). The cognizant agency is the agency that provides the recipient with the most direct funding. (Note: this will be redetermined in the year 2005 and every five years thereafter).

Cluster programs – a grouping of closely related programs that have common compliance requirements. (For example: R&D – Research and Development and SFA – Student Financial Aid).

Corrective action plan – addresses each audit finding noted in the audit report for current fiscal year. It provides: *name of the contact person responsible for corrective action, the corrective action to be taken, and the estimated completed date.* The purpose is to correct the deficiencies that have been cited; recommend improves; and/or confirms the validity of the audit findings or demonstrates their invalidity and states that no action is warranted. It should also include any explanations and/or reasons why the auditee does not agree with a finding or does not believe that a corrective action plan is necessary.

Materiality – a judgment call on the part of the auditor that takes into account both quantitative and qualitative factors.

Material weakness – a flaw in the structure in one or more of the internal control components that does not reduce risk to a relatively low level and increases the possibility of material misstatements in the financial statements.

Oversight agency – assigned to grant recipients who spend \$50 million or less in federal funds yearly. The oversight agency has a more limited role than a cognizant agency. Its role is to provide technical advice to auditors and auditees and can, by auditee request, assume some or all of the responsibilities performed by the cognizant agency.

Appendix B

Useful links

1. **Catalog of Federal Domestic Assistance** - <http://www.cfda.gov/>
2. **Data collection form** – <http://harvester.census.gov/sac>
3. **Frequently Asked Questions regarding audit requirements** - <http://harvester.census.gov/sac/faq.htm>
4. **Office of Management and Budget Circulars** - <http://www.whitehouse.gov/omb/circulars/>
5. **Search the Single Audit database** - <http://harvester.census.gov/sac/dissem/disclaim.html>
6. **Single Audit reference information** - <http://harvester.census.gov/sac/sainfo.html>

References

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