

Manual for Financial Evaluations of Public Health Service Awards



Blank Page

PUBLIC HEALTH SERVICE

**MANUAL FOR FINANCIAL
EVALUATIONS OF
PUBLIC HEALTH SERVICE AWARDS**

U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES

Revised September 1986

Blank Page

FOREWORD

This is the second revision to the Manual for Financial Evaluations of Public Health Service (PHS) Awards which was initially issued in 1975 and revised in 1979. This revision includes (1) organizational changes within PHS, (2) references to new policy documents, (3) new chapters applicable to reviews of program or grant-related income and matching and cost participation requirements, and (4) a new section on patient care costs.

The Manual presents guides for use by PHS grants and contracts management personnel in the performance of cost analyses of grant and/or contract proposals, reviews of financial management systems, and other related cost evaluation assignments.

Amendments to the Manual will be made as required. Consequently, recommendations should be submitted to the Director, Division of Grants and Contracts, Office of Resource Management, Office of Management, PHS. Awarding components may issue supplementary instructions relative to any particular feature of financial evaluations of grants and contracts, provided such instructions are consistent with the objectives of the Manual.

Copies of the Manual, additions, and amendments will be made available to agencies and regional offices for their use.

Office of Management
Office of the Assistant Secretary of Health
Public Health Service

Blank Page

CONTENTS

	<i>Page</i>
Foreword	iii
Contents	v
Chapter I	
Introduction to Financial Evaluations	1
Chapter II	
Responsibility for Financial Evaluations	3
Chapter III	
Preliminary Procedures for Cost Analyses	7
Chapter IV	
Review of Direct Labor	11
Chapter V	
Review of Fringe Benefits	17
Chapter VI	
Review of Direct Material and Supplies Costs	25
Chapter VII	
Review of Equipment	29
Chapter VIII	
Review of Space Rental	35
Chapter IX	
Review of Other Direct Costs	41
Alterations and Renovations	42
Subcontracts and Contracts Under Grants	45
Travel	46
Automatic Data Processing	48
Consultants	49
Meetings and Conferences	50
Patient Care Costs	52
Chapter X	
Review of Indirect Costs	55
Chapter XI	
Review of Matching and Cost Participation Under PHS Awards	63
Chapter XII	
Review of Program or Grant-Related Income	65
Chapter XIII	
Financial Management Systems Reviews	69
Questionnaire for Financial Evaluations of Grantee and Contractor Organizations	83
Chapter XIV	
Evaluation of Adequacy of Financial Capability	105
Chapter XV	
Use of Audit Reports	113
Chapter XVI	
File Documentation	121
Chapter XVII	
Source Material	126

Blank Page

Chapter I

INTRODUCTION TO FINANCIAL EVALUATIONS OF PUBLIC HEALTH SERVICE AWARDS

Some type of financial evaluation is necessary on applications and proposals considered for most PHS awards in order to provide assurances that (1) funding awarded for the project is a fair and reasonable amount, and (2) organizations receiving PHS awards have the financial management capability to administer those funds properly.

The concepts and procedures in performing financial evaluations as listed below are the subjects of this Manual. Their applicability to certain programs (e.g., loans, scholarships, or capital contributions) is limited in that they are included in other appropriate issuances.

1. Cost or Price Analysis of Proposed Elements of Cost

A cost analysis is the process of obtaining detailed cost breakdowns, verifying cost data, evaluating specific elements of cost, and examining data to determine the necessity, reasonableness, and appropriateness of the proposed cost.

A price analysis is the process of examining, evaluating, and comparing prospective prices without evaluation of the separate cost elements. A price analysis is solely applicable to contract situations for it assumes that the seller is operating in a competitive market.

The form and extent of the cost or price analysis is dependent on the results of program review or other peer review group data received, the nature of the project, past experience with the applicant organization, amount of the proposal, etc.

A form of price or cost analysis should be made in connection with every negotiated procurement action. A cost analysis is required for all discretionary project grant applications.

2. Review of Matching and Cost Participation Under PHS Awards

Some PHS programs (e.g., research projects) require that recipients of grants and/or contracts contribute to some extent by participating in the cost of the PHS project or that expenditures from grant/contract funds be matched proportionately by expenditures from other funds. The review of matching or cost participation will permit the cost analyst to (1) identify sources of income (non-Federal and other) which can be used to meet the matching or cost participation requirements, (2) assure that the organization has established adequate accounting procedures and controls for matching or cost participation purposes, and (3) ascertain that contributions are properly documented.

3. Review of Program or Grant-Related Income

Some organizations are accountable to PHS for certain kinds of program or grant-related income. Contracts under a grant are subject to the terms and conditions of the contract relative to the in-

come generated by the activities. These types of income include general program revenues, proceeds from the sale of assets acquired with project funds, royalties from copyrights on publications, etc. This chapter provides the cost analyst with guidance in the review of program income activities to ensure that the organization is complying with 45 CFR Part 74, Subpart F, requirements.

4. Financial Management Systems Reviews

A financial management systems review pertains to the overall evaluation of the current financial management policies, procedures, and controls maintained by an organization which affect the incurrence of costs. The examination of the financial management systems permits the cost analyst to assess the organization's accounting system(s) policies and procedures, budgeting, internal controls, property management, and the overall organizational structure.

5. Evaluation of Adequacy of Financial Capability

This permits the evaluator to assess the adequacy of an organization's financial resources and/or its ability to obtain sufficient resources to perform in accordance with the grant/contract objectives.

6. Use of Audit Reports

This chapter provides the cost analyst with information and guidance on the effective utilization of audit reports. It includes the various types and sources of audit reports and steps that should be taken in arriving at opinions concerning the reliability of a prospective awardee's cost data, financial management systems, and other pertinent business practices.

7. Recommendations from Other Parties

Where appropriate, the recommendations from PHS cost advisory accountants, the HHS Office of Audit, and other accounting services become an integral part of the financial evaluation.

8. File Documentation

Data on cost analyses performed, accounting systems reviews completed, and other financial management information which support and justify award recommendations must be maintained in the official award file.

Chapter II

RESPONSIBILITY FOR FINANCIAL EVALUATIONS

In the financial evaluation process, certain responsibilities have been assigned to individuals through various Federal regulations and policies. The responsibilities of the respective individuals as they relate to PHS contracts and grants follow.

1. Contracting Officers

Subpart 15.805 of the Federal Acquisition Regulations states that the contracting officer, in coordination with a team of experts, exercises sole responsibility for the final pricing decision. The regulations also state that “. . . (b) When cost or pricing data are requested, the contracting officer shall make a cost analysis to evaluate the reasonableness of individual cost elements. In addition, the contracting officer should make a price analysis to ensure that the overall price offered is fair and reasonable. When cost or pricing data are not required, the contracting officer shall make a price analysis to ensure that the overall price offered is fair and reasonable. . . .”

2. Grants Management Officers

- a. The Grants Administration Manual (GAM), Part PHS: 611, “Financial Evaluation of Grant Applications,” incorporates the PHS policy requiring a financial evaluation to be performed on all discretionary project grant applications approved to be funded by PHS. Applications that do not require detailed budget statements are excluded from the cost analysis portion of the financial evaluation. A financial evaluation involves a cost analysis, a determination of the adequacy of the grantee’s accounting system, and other reviews of financial management capabilities.

The form and the extent of the cost analysis will be determined by the Grants Management Officer (GMO) of the awarding component after considering such factors as program and/or other peer group reviews, the amount and types of cost being requested, the nature of the project, and past experience with the applicant organization.

If a prospective grantee has no prior Government grants or contracts, the GMO must, prior to award or within a reasonable time thereafter, review (or cause to be reviewed) the applicant organization’s accounting system to be assured of its adequacy and acceptability. Where minor deficiencies in a grantee’s accounting system are indicated, the GMO will condition the award pending resolution of the deficiency. Where major deficiencies are found, the GMO will delay award until the organization has corrected all cited deficiencies.

The GMO is also responsible for maintaining adequate documentation in the official file on cost analyses performed and applicable accounting systems reviews completed.

- b. GAM Part PHS: 101, “Grants Management Officer Responsibilities in the Administration of PHS Grants,” which establishes GMO’s functions and responsibilities in the administration, evaluation and monitoring of grants also requires GMOs to perform a cost analysis on approved

grant applications prior to award of a grant. Additionally, GMOs must also (1) survey, or cause to be surveyed, a prospective grantee's business management system(s) whenever appropriate or when required by applicable policies, (2) negotiate any required matching or cost participation agreement prior to award of a grant, except where a uniform minimum percentage of matching or cost participation is required by statute or regulation, (3) provide for continuous surveillance of the financial and management aspects of grants through site visits or other appropriate means, (4) request or arrange for special audits of grants whenever deemed necessary, (5) participate in the resolution of audit findings involving grants, and (6) maintain the general program information files and individual grants folders required by GAM Part PHS: 104, "Required Documentation Under PHS Grant Programs."

- c. GAM Part PHS: 700, "Exceptional Organizations," provides, in part, guidance in the identification of organizations which show evidence of poor business management practices. This chapter requires GMOs to make every effort to identify these organizations before a grant is awarded and to take appropriate action to protect PHS's interest. Generally, GMOs should consider the following factors in determining if an organization is exceptional on the basis of poor management practices, poor financial stability or financial dependency on Federal support, inexperience, inability to comply with applicable administrative requirements, or a history of unsatisfactory performance. See Part PHS: 700 for a detailed explanation of GMOs responsibilities in these cases.
- d. GAM Part PHS: 701 and HHS Procurement Manual Circular 84-01 address the HHS Alert System which identifies individuals and/or organizations that:
 1. May present a relatively high risk that warrants special action or attention to safeguard the Government's interests because of certain kinds of specific events or conditions.
 2. Are suspended, debarred, or otherwise excluded from certain Government programs because of their engagement in serious misconduct.

3. HHS Divisions of Cost Allocation

The responsibility for negotiating indirect cost rates for all organizations other than profitmaking organizations rests with the Division of Cost Allocation (DCA), within the appropriate Regional Administrative Support Center (RASC). This office also has the responsibility for the routine negotiation of fringe benefits, patient care cost rates, computer rates, and other special rates as well as providing technical assistance to grantee and contractor organizations.

4. HHS Office of Audit

The HHS Office of Audit (HHS/OA) provides, upon written request, audit assistance in each regional office to perform quick assessments of some of the more significant business management practices of selected grantees and contractors. Agencies or regional offices may request these services through their audit liaison representatives. Such requests should provide sufficient data to indicate the reasons for the reviews.

Additionally, on request and based on the availability of time and resources, HHS/OA auditors may:

- a. Perform comprehensive audits of PHS supported organizations.
- b. Conduct followup reviews and special analyses to determine the propriety of action taken on previous audit findings and recommendations.

- c. Perform special reviews of PHS project proposals to determine the financial capability of the applicant organization.

5. Cost Advisory Staffs

Headquarters' agencies have professional accounting staffs available to assist in the financial evaluation of proposed grants and contracts. The names and telephone numbers of these offices are listed below:

Financial Advisory Services
Division of Grants and Contracts Management
Alcohol, Drug Abuse, and Mental Health Administration
Phone: FTS 443-6650

Cost Advisory and Audit Section
Accounting Branch
Financial Management Office
Centers for Disease Control
Phone: FTS 236-6826

Division of Contracts and Grants Management
Food and Drug Administration
Phone: FTS 443-2525

Cost Advisory Branch
Division of Grants and Procurement Management
Health Resources and Services Administration
Phone: FTS 443-6507

Financial Advisory Services Branch
Division of Contracts and Grants
National Institutes of Health
Phone: FTS 496-4401

Review and Assessments Branch
Division of Acquisition Management
Administrative Services Center
Office of Management
Office of the Assistant Secretary for Health
Phone: FTS 443-0010

Among the services provided are:

- a. Accounting counsel to program managers, contracting officers, grants management officers, and contractor and grantee organizations.
- b. Review of proposed contract and grant actions including the analysis of budget proposals.
- c. Examination and analysis of contractor and grantee management and accounting systems, financial statements, internal controls, etc., and providing advice regarding the acceptability of an applicant's financial management system.
- d. Liaison with the Office of the Secretary and the Department's regional staff in determining the applicability and appropriateness of indirect costs.

- e. Negotiation of indirect cost rates for profitmaking organizations.
- f. Assistance in desk audit reviews of completed contracts.
- g. Assistance and/or direct resolution of audit findings.

6. PHS Project Technical Officers, Objective Review Groups

To the extent possible, PHS cost analysts should consult with project technical officers, or members of objective review groups, to obtain quantitative and qualitative advice regarding the technical aspects of PHS project proposals received. Project technical officers and members of objective review groups (e.g., peer review, standing committee) are often responsible for determining the necessity, quantity, or quality of items in a proposed budget or cost proposal. These individuals are also involved regularly with staff of the applicant organization and work closely with the PHS project administration office in the project award process, and can provide helpful information regarding the financial evaluation of PHS projects, budgets, and/or cost proposals.

7. Cost and Audit Management Branch, Division of Grants and Contracts, Office of Resource Management, Office of Management, PHS

The Branch has a staff of financial and administrative professionals who are available to provide, on request, guidance on any aspect of the financial evaluation of PHS awards. Some of the major responsibilities of this Branch include the following:

- a. Establishment of criteria, standards, and procedures for reviewing, evaluating, and monitoring the financial management capabilities of PHS supported organizations.
- b. Serving as the PHS focal point concerning the interpretation and application of cost policies and principles relating to PHS supported projects.
- c. Serving as the liaison between PHS agencies and HHS/OA on audit matters.
- d. Providing training to staff of PHS components on the interpretation and application of Federal, departmental, and other cost policies and principles.

The phone number of the Branch is FTS 443-3080.

Chapter III

PRELIMINARY PROCEDURES FOR COST ANALYSES

A cost analysis is the process of obtaining, verifying, and evaluating data supporting each element of cost of the grantee budget or contractor proposal.

The general procedures listed below are normally performed prior to the evaluation of specific elements of cost (e.g., direct labor, fringe benefits, direct material). Such steps will aid individuals in determining the form and extent of cost analyses to be performed.

<i>Steps</i>	<i>Comments</i>
1. Determine the name and title of the individual responsible for the preparation of the proposed budget.	1. Preliminary contacts regarding the budget should usually be with the organization's business office. A principal investigator is not normally authorized to obligate an organization on financial matters.
2. Determine whether a cost analysis is necessary.	2. Contracts—Some form of price or cost analysis is required in connection with every negotiated procurement action. Grants—A cost analysis is required for all discretionary project grant applications approved to be funded by PHS, except those awards which do not require detailed budget statements.
3. If a cost analysis is required, determine whether it is the organization's first PHS award.	3. The initial contact with the organization is critical. As such, dollar impact should not be the principal criterion in determining the level of effort to be expended. Extra effort should be taken to insure that the organization understands PHS requirements.
4. Determine whether internal files contain any current information on the organization.	4. Files may contain information on organizational structure, policies and procedures regarding salaries, fringe benefits, travel, etc., and other financial data.
5. Determine whether the organization has received grants and/or contracts from any other Federal agency.	5. Information derived from other sources can be of assistance in evaluating current budget proposals. Such data may also serve to limit the extent of cost analysis needed.

6. Determine whether any audits of the organization have recently been completed (e.g., by HHS/OA, other Federal agencies, independent accountants, or State auditors).
7. If it is a renewal or continuation award, review prior awards for comparability and reasonableness to the current proposal.
8. Determine if the budget is in conformance with statutory or administrative requirements.
9. Determine the extent of effort to be expended on the review.
10. Obtain program or other peer review group data.
11. Verify the accuracy of mathematical computations.
6. Audit reports may be found in the permanent and/or a previous file. Additionally, the prospective awardee or the HHS/OA Audit Coordination Division may be called to determine whether any governmental agency has recently conducted an audit of their costs, operations, financial management systems, etc.

If deficiencies are cited in the audit report, there should be an attempt to have the organization correct them or the award should be conditioned until adequate resolutions are effected. If major deficiencies are noted, award may be delayed until the organization makes the necessary corrections.
7. If the proposal under review appears reasonable in comparison to the prior award, no indepth review may be necessary. This applies only where the scope or effort has not changed significantly.
8. Frequently, statutory or administrative requirements place limitations on the recovery of certain elements of cost, (e.g., indirect cost reimbursement, construction costs, alterations and renovations).
9. The extent of the review is dependent upon the following:
 - a. Past experience with the organization.
 - b. Total dollar impact of the cost proposal.
 - c. Extent to which proposed cost items are verifiable to supporting documentation.
 - d. Other known factors that may affect the organization's financial capability to operate under the award.
10. Program or other peer groups are responsible for determining the necessity, quantity, and/or quality of the cost items included in the budget. As such, they can provide valuable information in the financial evaluation process.
11. Sometimes budgets include mathematical errors due to either transpositions or human error. Therefore, it is important to ascertain that budget proposals are accurate.

12. Scan the entire application.

12. The following is a list of the types of items that should be looked for in scanning the budget:
- a. Unallowable costs (e.g., entertainment, interest).
 - b. Lack of grantee/contractor understanding of the difference between direct and indirect charges (see Chapter X).
 - c. Excessive or inadequate indirect cost rates (see Chapter X).
 - d. Need for offsite indirect cost rates if there are offsite direct charges (see Chapter X).
 - e. Submission of the application without going through the organization's business office.

Blank Page

Chapter IV

REVIEW OF DIRECT LABOR

I. Introduction

By definition, compensation for personal services refers to any remuneration, in whatever form, for services rendered by employees. It includes, but is not limited to, salaries, wages, bonuses, incentive awards, staff benefits, contributions to pension/annuity plans, allowances for offsite pay, location allowances, hardship pay, and cost-of-living differentials.

Due to the common error of direct charging typical indirect labor to projects, Federal programs may receive duplicate costs for the same item. Therefore, it is of utmost importance to understand and distinguish between direct and indirect labor.

Direct labor refers to costs for personal services which can be directly identified with a project or activity or which can be directly assigned to such activities with a high degree of accuracy. For instance, direct labor at a university refers to, but is not limited to, those costs directly attributable to research, instruction, or other organized activities.

Indirect labor refers to those costs which are not readily identifiable with a single project or activity, but rather, are necessary for the overall operation of the organization. Areas which are frequently charged as indirect include, but are not limited to, general and administrative personnel (e.g., president, vice-president, controller, business manager, payroll clerk) and operation and maintenance of an organization (e.g., janitors, repairmen, gardeners, security). Indirect costs are discussed in detail in Chapter X.

II. Objective of Review

The primary objective of the direct labor review is to determine that the direct labor cost proposed is reasonable under the circumstances. This involves ascertaining that:

- A. The total amount paid is commensurate and consistent with compensation paid under the organization's established policy.
- B. The total compensation paid is comparable to that paid for similar work in the labor market in which the organization competes for employees. This is necessary with organizations receiving the majority of their funds from Federal sources.
- C. The rates or costs proposed are commensurate with the type of work being performed.

III. Areas of Particular Concern

The following is a list of problem areas relative to the charging of direct labor costs. The existence of any of these items in a particular project does not necessarily indicate that an award

cannot be processed. It does suggest, however, that a problem may exist and that the cost analyst should act accordingly.

These problem areas include:

- A. Difficulty in many instances with the awardee organization of either understanding or distinguishing between direct and indirect labor.
- B. Inclusion of consultant fees as part of direct labor.
- C. Absence of written personnel policies and procedures designed to differentiate between levels of responsibility and complexity of work.
- D. Lack of current written position descriptions and applicable titles.
- E. Lack of current and complete pay scales or those which have not been evaluated for reasonableness.
- F. Inadequate accounting system to accurately account for labor costs.

IV. Detailed Procedures

The following procedures are intended to serve as a guide in the review and evaluation of direct labor. The extent of the evaluation and the preliminary procedures to be followed prior to the evaluation are discussed in Chapter III, "Preliminary Procedures For Cost Analyses."

1. Insure that proposed direct labor has been presented in sufficient detail for review.
 1. Analyses to determine reasonableness cannot be made if direct labor has not been presented in sufficient detail. The organization should supply the following data:
 - a. Name and/or job titles for all individuals budgeted for award.
 - b. Rate of pay for each individual and labor category.
 - c. Level of effort (percentage or hours) for each individual or labor category, whichever is applicable.
 - d. Other information deemed necessary.
 2. In order to adequately evaluate the proposed direct labor cost, certain background information must be supplied. Permanent or award files should be checked to determine whether any of this information has been submitted previously. The following list is not intended to be all inclusive, but rather to be used as a guide in determining the basic information needed to perform an indepth review of direct labor.
 - a. Name and/or job title of those individuals or labor categories scheduled for assignment to the project should be listed on the application (see 1.a. above). Such infor-
2. Determine that sufficient data and documentation needed to evaluate direct labor have been submitted.

- mation should correspond to the labor categories established by the organization as set forth in its personnel policies. (See comment 6.b.(3), Section IV, Chapter XIII, "Financial Management Systems Reviews".)
- b. Pay scales of the organization are needed. If the organization does not have written pay scales, annual salary rate of pay should be provided by individual(s) or position(s). (See comment 6.b.(2), Section IV, Chapter XIII, "Financial Management Systems Reviews".)
 - c. If direct identification of individuals working on the project is possible, their current salary rate of pay should be submitted.
 - d. If estimates are used (e.g., estimated salaries, inflation factors, differential pay), data from which estimates were derived are needed.
 - e. Any other relevant information necessary to make an informed judgement should be included.
3. If it is a renewal or continuation award, determine whether any advance agreements were established in prior years and, if so, whether the organization complied with the agreements for the proposal under review.
 4. Determine that position descriptions and pay scales are current.
 5. Compare job titles and salary amounts proposed on the award application with those established by the organization.
 6. Determine that proposed salary rates are based on the individual's regular compensation under the organization's policy.
3. In prior evaluations, advance agreements may have been established to preclude disputes or problems. Examples of such agreements applicable to direct labor include:
 - a. Changes in organization's accounting system to identify time and effort more accurately.
 - b. Treatment of certain types of labor categories.
 - c. Performance of special studies or analyses in connection with the development of future proposals.
 - d. Limitation on certain labor categories (e.g., stipulated salaries and wages).
 - e. Bonuses and incentive compensation.
 4. Outdated information does not apply to project awards. (See comment 5.a., Section IV, Chapter XIII, "Financial Management Systems Reviews".)
 5. This is to insure that salaries proposed are consistent with the organization's established personnel policy.
 6. Charges for work performed are allowable only at the individual's base salary rate. The base salary rate is that level for which the

individual is regularly compensated under the practice established by the organization.

7. If an organization is unable to provide established pay scales, determine the basis used to estimate salaries and whether base salaries are reasonable under the circumstances.
 8. If an organization proposes a labor class (e.g., laboratory technicians, clerical) rather than specific position description or job title, determine the accuracy and propriety of the method used in computing averages.
 9. If inflation factors or other methods are used to estimate future increases, determine the propriety of such method.
 10. Determine whether direct labor includes fringe benefits such as vacation, holiday, and sick leave.
 11. If labor of a subcontractor and/or contractor under a grant or other secondary recipient is being proposed, determine the propriety of applying the indirect cost rate to these groups.
 12. Determine if there is possible duplication due to the direct charging of typical indirect labor costs.
7. Salary estimates should be analyzed for reasonableness by comparing them to appropriate salary surveys for comparable positions. (See Section V, "Source Material" of this chapter.)
 8. The organization's policy on salary ranges for a given labor class or appropriate salary surveys may be used in establishing reasonableness
 9. Written organizationwide, cost-of-living increases may be one method for proposing future labor costs. Other bases used to estimate future labor increases include: national cost-of-living rate, analysis of organization's historical salary increases, and any other approach as deemed reasonable and equitable.
 10. Review of fringe benefits is discussed in Chapter V, "Review of Fringe Benefits." However, it should be ascertained that where fringe benefits have been included as part of direct labor or in the indirect cost pool, they are not included as a separate cost element on the award proposal as well. Refer to the HHS Indirect Cost Rate Negotiation Agreement for a determination of the treatment of these benefits.
 11. Outside services do not produce indirect costs to the same extent as internal personnel; consequently, it is often inappropriate to apply the primary organization's indirect cost rate to these individuals' labor costs.
 12. The following is a partial list of costs normally included as part of the indirect cost pool. Further discussion of indirect costs are included in Chapter X, "Review of Indirect Costs".
 - a. Administration – director, department head.
 - b. Personnel – personnel director.
 - c. Accounting – controller, bookkeeper.
 - d. Procurement – purchasing director, stockroom clerk.

- e. Housekeeping and Maintenance—custodial and janitorial, repairman, groundskeeper.
13. Determine whether students, fellows, or trainees, are being proposed as direct labor charges to PHS research projects with educational institutions.
14. Determine the propriety and reasonableness of summer salaries proposed under PHS projects with educational institutions.
15. Determine whether the organization has established adequate payroll distribution and/or time and effort reporting requirements.
16. Evaluate the reasonableness of the proposed labor costs.
13. Costs of scholarships, fellowships, and other forms of student aid apply only to instruction and, therefore, are unallocable to PHS research agreements. However, in the case of students engaged in work under research agreements, tuition remissions for work performed are allowable to such research agreements as direct labor costs provided consistent treatment is accorded such costs. (See OMB Circular A-21, "Cost Principles Applicable to Educational Institutions," and Grants Administration Manual Part PHS: 203, "Compensation of Students and Trainees Under Research Grants".)
14. Monthly charges for work performed by faculty members on PHS projects during the summer months or other periods not included in the base salary period must not exceed the base salary monthly rate. The base salary monthly rate is computed by dividing the base salary by the number of work months in the period for which the salary base is paid.
15. See comment 6.c., Section IV, Chapter XIII "Financial Management Systems Reviews."
16. The following procedures may be used in determining reasonableness:
 - a. Compare salary costs/rates budgeted with those appearing in other similar current proposals from other organizations.
 - b. Compare salary costs/rates budgeted with those included in previous proposals or other prices or costs paid in earlier projects.
 - c. Compare salary costs/rates budgeted with those cited in the publications listed in Section V, "Source Material," of this chapter.
 - d. Ensure that the types and classes of personnel categories proposed are necessary for the achievement of the project.
 - e. Ensure that the salary costs/rates proposed are commensurate with expected assignments and responsibilities.

V. Source Material

In order to adequately evaluate the reasonableness of proposed salaries and wages, there are numerous sources currently available. The following is a limited list of some of these surveys and a brief description of what they include:

- A. Area Wage Surveys, published by the Department of Labor, Bureau of Labor Statistics (BLS).

These are separate reports for 70 metropolitan areas showing average wages and middle ranges for each position including position description. This survey covers office clerical personnel, certain professional and technical positions, maintenance, power plant, custodial, and material management.

- B. Service Contract Act Surveys, published by the Department of Labor, BLS.

This is similar to area wage surveys except it is done under contract with BLS. It covers approximately 80 metropolitan areas which are not covered by the area wage surveys.

- C. National Survey of Professional, Administration, Technical, and Clerical Pay, published by the Department of Labor, BLS.

This is a single nationwide survey showing average salaries and middle ranges for each position including position descriptions. The survey applies to accountants, auditor, attorneys, chemists, engineers, engineering technicians, tracers, job analysts, personnel directors, business managers, buyers, and clerical positions.

- D. Industry Wage Surveys, published by the Department of Labor, BLS.

These are separate reports covering various types of industries (e.g., hospitals, nursing homes) including positions unique to the particular industry along with applicable average salaries.

- E. National Survey of Compensation Paid to Scientists and Engineers Engaged in Research and Development Activities, published by the Batelle Columbus Laboratories, Columbus, Ohio, under contract with the Department of Energy.

This report covers compensation paid to scientists and engineers engaged in research and development in various types of organizations (e.g., universities, private nonprofit organizations, commercial organizations). The survey shows average salaries broken down by field and type of employee.

Chapter V

REVIEW OF FRINGE BENEFITS

I. Introduction

Fringe benefits are allowances and services provided by the organization to its employees as compensation in addition to regular wages and salaries. Fringe benefits are appropriate charges to the extent such benefits are:

- A. In accordance with established policy of the organization.
- B. Required by employer/employee agreement.
- C. Treated consistently.
- D. Required by law.

II. Types of Fringe Benefits

- | | |
|-----------------------|---|
| A. Vacation* | K. Employee welfare and recreation |
| B. Holiday* | L. Severance pay |
| C. Sick leave* | M. Jury Duty |
| D. Bereavement leave* | N. Tuition remission |
| E. Military leave | O. Remission of hospital charges |
| F. Sabbatical leave | P. Social Security taxes (FICA)* |
| G. Salary continuance | Q. Unemployment Compensation Insurance* |
| H. Health insurance | R. Workman's Compensation Insurance* |
| I. Life insurance | S. State Disability Insurance |
| J. Pension plan | T. Federal Unemployment Insurance* |

*See Section III below for more detailed descriptions.

III. General Description of Selected Fringe Benefits

- A. Vacation is time-off provided to the employee. The normal allotted time is 2 weeks annually, but up to 20 days may be considered reasonable and appropriate. (See Note at the end of this section.)
- B. Holidays are those days granted by the employer through established policy on which the employees are exempt from work. Normally, the number of holidays may vary from 6 to 10 days per year. The following are examples of the most common holidays:

New Year's Day
Memorial Day
Independence Day

Labor Day
Thanksgiving Day
Christmas Day

If consistently applied, certain additional holidays may also be granted according to the organization's policy, such as employee's birthday or extra days to provide the employee with longer weekends.

- C. Sick leave is absence due to illness or other unexpected incapacity. Up to 13 days annually could be considered acceptable if in accordance with the organization's established procedures. (See note below.)
- D. Bereavement leave of absence is usually granted due to the death or the critical illness of an immediate member of the family. The normal time-off allowed is 3 days.
- E. Federal Insurance Contributions Act (FICA) taxes (social security contributions) are payable by the employer/employee on an equal basis.
- F. State Unemployment Compensation Insurance standard rate is 2.8 percent. However, the contribution rate may range from 0.0 percent to 6.0 percent. The rate is applied to a portion of the employee's gross salary, and is fully contributed by the employer. (Check with appropriate State for the applicable rate and employee's salary base.)
- G. Workman's Compensation Insurance is fully contributed by the employer and varies according to the organization's claims experience.
- H. Federal Unemployment Insurance base rate is 0.7 percent to a maximum rate of 3.5 percent applicable nationwide. The rate is applied to a portion of the employee's gross salary and is fully contributed by the employer.

NOTE: The number of days considered as reasonable for vacation and sick leave is based on the standard allowances or leave time applicable to Federal Government employees. However, a greater number of days may also be reasonable depending on the established organizational policy, practice of other organizations of comparable size and nature, etc.

IV. Objective of Review

The primary objective of the fringe benefits review is to determine that the benefits proposed are reasonable, allowable, and applicable.

This involves the following steps:

- A. Determine whether the organization has negotiated a currently effective fringe benefits rate with the Division of Cost Allocation (DCA)/Regional Administrative Support Center (RASC).
- B. Ascertain that the total amount paid is commensurate and consistent with fringe benefits paid under the organization's established policy.
- C. Ascertain that those fringe benefits paid are comparable to that paid in the labor market in which the organization competes for employees. This is necessary, where an organization receives the majority of its funds from Federal sources.
- D. Ascertain that the organization has complied with Federal and State laws and regulations.

V. Areas of Particular Concern

The following is a list of problem areas relative to the charging of fringe benefits. The existence of any of these items on a particular project does not necessarily indicate that an award cannot be processed. It does suggest, however, that a problem may exist and that further investigation is warranted.

These problem areas include:

- A. Charging fringe benefits applicable to Government awards directly while charging all other fringe benefits of the organization indirectly.
- B. Lack of a consistent, written policy regarding fringe benefits.
- C. Excessive fringe benefits for executives.
- D. Understanding and applying different Federal and State requirements regarding fringe benefits.
- E. Where a fringe benefit rate is used—understanding its component parts, the base for application, and handling of actual overages/underages.

VI. Treatment of Fringe Benefits (Direct vs. Indirect)

Treatment of fringe benefits is very individualized and will, therefore, vary by organization.

If fringe benefits are treated as direct costs, they are directly identifiable to a given salary or wage. If fringe benefits are treated as indirect costs, all benefits within a given class are pooled together. Consequently, the organization is receiving applicable reimbursement through its indirect cost rate or fringe benefit rate.

However, an organization may elect to separate fringe benefits and treat one class directly and another indirectly. For example, certain costs, such as Workman's Compensation Insurance and State Unemployment Compensation Insurance, which are not easily identifiable to given individuals, may be treated as indirect costs. The remaining benefits, more readily identifiable to given individuals, may be charged directly. Additionally, some organizations elect to treat certain types of fringe benefits as regular compensation paid to employees, usually in the form of authorized absences, such as vacation, holiday, sick leave, etc. In such instances, the benefits are considered to be salaries or wages and are charged in a manner similar to that of labor costs. Regardless of the method of costing (e.g., direct, indirect, or combination of both), the organization must do it consistently.

VII. Detailed Procedures

The following procedures are intended to serve as a guide in the review and evaluation of fringe benefits. The extent of the evaluation and the preliminary procedures to be followed prior to the evaluation are discussed in Chapter III, "Preliminary Procedures for Cost Analyses."

Steps

1. Determine that sufficient data and documentation needed to evaluate fringe benefits have been submitted.

Comments

1. In order to adequately evaluate the proposed fringe benefits, certain background information must be provided by the organization. The following list is not intended to be all inclusive, but rather, to be used as a guide in determining the basic information needed to perform an indepth review of fringe benefits.
 - a. If a fringe benefit rate is proposed, determine whether the organization is a non-profit or profitmaking entity.
 - 1) Nonprofit—Determine whether the rate is current and has been reviewed and approved (negotiated) by the appropriate DCA/RASC.
If the rate has not been reviewed by DCA, request an opinion from that office concerning the acceptability of the rate.
 - 2) Profitmaking—By consultation with the applicant organization, determine whether the rate has been reviewed and approved by another awarding component within PHS, HHS, or the Federal Government. If so, contact such office for a verification of such information. Where the proposed rate has not been reviewed or approved by another Federal Government agency, a test of reasonableness should be made by comparing total fringe benefits paid in the most recently completed fiscal year with those paid by similar firms in the area, doing the same type of work.
 - b. For an evaluation of fringe benefits not proposed by means of a rate, see step and comment 11.
 - c. Written policy on the type and makeup of fringe benefits paid by class of employee is needed. (Organizational handbook issued to new employees may contain this information.)
 - d. Names (if applicable) and job titles of those individuals who will perform on the project are needed.
 - e. If direct identification of individuals working on the project is possible, obtain data on most recent fringe benefits paid by items and amount.

- f. If estimates are used (e.g., anticipated changes in Federal or State laws, increases in pension funds), obtain data from which estimates were derived.
 - g. Written policy is needed of how various fringe benefits are to be treated (e.g., direct vs. indirect).
 - h. Any other type of information necessary to make an informed judgment should be supplied.
2. If it is a renewal or continuation application, determine whether any advance agreements were established in prior awards and, if so, whether the organization complied with the agreements for the proposal under review.
 3. Determine treatment of fringe benefits (e.g., direct or indirect).
 4. Determine whether the organization has elected to treat some classes of fringe benefits as personal compensation.
2. In prior evaluations, advance agreements may have been established to preclude disputes or problems or to help insure more equity in the future. Examples of such agreements applicable to fringe benefits include:
 - a. Changes in the organization's accounting system to identify more accurately certain types of fringe benefits.
 - b. Treatment of certain types of fringe benefits.
 - c. Performance of special studies or analyses in connection with the development of future proposals.
 - d. Limitation on certain fringe benefits.
 3. If the organization is charging one class of fringe benefits directly to the PHS activity, determine that this is consistent with the method used for determining the indirect cost rate (e.g., if the organization has elected to treat one class of fringe benefits as indirect costs, it cannot charge them directly to any grant or contract regardless of any other restriction placed on the award). This information is contained in the HHS Indirect Cost Negotiation Agreement.
 4. Many organizations treat the cost of authorized absences such as vacation, holidays, sick leave, and other time off, as part of the personnel compensation cost category. The reviewer should ensure that such items are not duplicated in the personnel compensation and fringe benefit categories so as to prevent overrecovery of these costs by PHS supported organizations.

5. Compare types and amounts of fringe benefits proposed on the application with those established by organizational policy.
 6. If individuals who are to work on a project activity are identifiable, compare current fringe benefits with those proposed on application.
 7. Ensure that fringe benefit plans include those perquisites required by law.
 8. If proposed fringe benefits are based on estimates, determine the propriety of the method used.
 9. If a fringe benefit rate is used, determine whether the organization is a nonprofit or profitmaking entity.
5. Insure that the organization charges similar types of fringe benefits to other areas as it does to Government activities. In determining reasonable amounts, comparison to other organizations of similar size, nature, and type may be useful.
 6. Fringe benefits each year should not differ substantially unless some change in organizational policy or Federal or State law has taken place.
 7. All fringe benefit plans must, at a minimum, provide the following perquisites:
 - a. Social security contributions or a substitute State plan where permitted.
 - b. Federal unemployment insurance contributions.
 - c. State unemployment compensation insurance contributions.
 - d. Workman's compensation insurance coverage.
 8. The organization may use one or a combination of the following methods for estimating fringe benefits:
 - a. Past experience for a given type of position.
 - b. Fringe benefits of a comparable organization.
 - c. Anticipated organization, Federal, or State regulation changes, etc.

Regardless of the method used, a test of reasonableness should be made by comparing total fringe benefits paid in the most recently completed fiscal year with that of total salaries paid. (This information may be contained in the organization's certified financial statements.)
 9. Nonprofit—In addition to negotiating indirect cost rates, a DCA office may negotiate the establishment of fringe benefit rates if the organization uses a rate to charge and bill fringe benefits.

Profit—The propriety of a fringe benefit rate for a profitmaking organization may best be determined by comparing the rate proposed with the most recent historical fringe benefit rate available, or by comparing the benefit rate with that of an organization of similar nature, type, and size.

10. If only one fringe benefit rate is proposed, determine whether two or more would be more equitable.
11. If fringe benefit costs are not being proposed by means of a rate, determine the composition of the costs (by classes of benefits), percentages used in computing the cost, and personnel to whom benefits apply.
12. If this is a profitmaking organization, determine whether the organization has a written policy for handling overages/underages of the fringe benefit rate.
13. Determine overall reasonableness of fringe benefit costs proposed.
10. Very often where different classes of individuals are employed (e.g., professional and clerical), two or more fringe benefit rates may be appropriate.
11. Benefits offered should include those required by law. Percentages used in computing these costs should not exceed those required by law. You may contact the local Internal Revenue Service (IRS) or State income tax office for additional guidance (e.g., private nonprofit 501(c)(3) organizations are exempt from paying Federal unemployment). As for other benefits offered, reasonableness may be determined by comparing benefits available to employees of organizations of similar nature, type, and size.
12. Regardless of the method used, the organization must have a written policy consistently applied for handling overages/underages of the fringe benefit rate. Any one of the following is acceptable:
 - a. Incorporating overages/underages into the indirect cost pool.
 - b. Incorporating overages/underages into the fringe benefit rate of the following year.
 - c. Adjusting the current fringe benefit rate to include overages/underages, and then rebilling for any differences. In the case of nonprofit organizations, the appropriate DCA office will evaluate the propriety of the organization's policy in this regard.
13. Fringe benefit plans usually include the following features:
 - a. Medical insurance
 - b. Disability benefits
 - c. Pension Plan
 - d. Death benefits
 - e. Paid absences
 - f. Taxes and contributions required by law (e.g., FICA and Unemployment Compensation Insurance).

When the time-off-with-pay benefit is treated as part of the salary cost, the remainder of the fringe benefit plan usually will not exceed 20 percent of salary costs when the organization offers retirement income (pension.) Where no retirement in-

come is offered then the remainder of the fringe benefit plan should be about 12 percent of salary costs.

The U.S. Chamber of Commerce publishes annually a survey of fringe benefits by various classes of industrial groups (e.g., hospitals, nonmanufacturers, etc.), and by major geographical location.

Chapter VI

REVIEW OF DIRECT MATERIAL AND SUPPLIES COSTS

I. Introduction

Direct material and supplies costs consist of those costs incurred for purchased goods and fabricated parts directly related to a project proposal, and may include such other items as transportation and in-transit insurance.

Direct materials and supplies differ from equipment in that they are consumable, expendable, and of a relatively low unit cost.

II. Objectives of Review

The objectives of the direct material and supplies costs review are to ascertain that:

- A. The proposed goods are consistently treated within the accounting system of the organization.
- B. The proposed costs can be verified to supporting documentation.
- C. The costs proposed for materials and supplies are reasonable in amount in view of actual prices, appropriately adjusted by such credits as trade discounts, refunds, rebates, allowances, and cash discounts.

III. Areas of Particular Concern

The following is a list of problem areas relative to the charging of direct material and supplies costs. The existence of any of these items does not necessarily indicate that an award cannot be processed. It does suggest, however, that a problem may exist and that the cost analyst should act accordingly.

These problem areas include:

- A. Lack of consistent accounting treatment in the charging of direct material and supplies costs.
- B. Failure to offset material costs with income and credits such as cash discounts, trade discounts, refunds, rebates, and allowances.
- C. Inadequate system for estimating material costs.
- D. Inadequate inventory control to identify kind, location, amount, etc., of materials on hand.
- E. Purchase of material from a parent or subsidiary company with a charge for profit, unreasonable, or unnecessary cost.

- F. Lack of competitive bidding on the part of vendors on purchases of certain material items.
- G. Lack of consistency between the procedure used for recording costs and that used for proposing costs.

IV. Detailed Procedures

The following procedures are intended to serve as a guide in the review and evaluation of materials costs. Determination of the extent of the evaluation necessary and the preliminary procedures to be followed prior to the evaluation are discussed in Chapter III, "Preliminary Procedures for Cost Analyses."

<i>Steps</i>	<i>Comments</i>
<ol style="list-style-type: none"> 1. Determine that sufficient data and documentation needed to evaluate material costs have been submitted. 	<ol style="list-style-type: none"> 1. In order to evaluate adequately the proposed material costs, certain background information should be supplied. The following list is not intended to be all inclusive, but rather, to be used as a guide in determining the basic information needed to perform an indepth review of material costs. <ol style="list-style-type: none"> a. A listing of materials proposed. Where applicable, stock numbers, part numbers, quantities, and unit prices should be included for items of significant dollar value. b. The basis used by the organization in estimating material costs. c. Information on the organization's accounting treatment of materials costs not directly related to project activity. d. The organization's documentation (e.g., support data for prices quoted). e. Data from which estimates, if used, were derived (e.g., spoilage factor, returns to vendors, allowances, and rebates). f. Any other types of data necessary to make an informed judgment.
<ol style="list-style-type: none"> 2. If it is a renewal or continuation grant or contract, compare proposed material costs with those expended in prior years. 	<ol style="list-style-type: none"> 2. When material costs have increased substantially over prior years, determine whether increases are justifiable (e.g., material costs may have increased due to an increase in level of work, hiring of additional personnel).
<ol style="list-style-type: none"> 3. If the organization is able to supply a detailed schedule of materials, compare the unit cost for large dollar items to supportive documentation (e.g., recent invoices, vendor bids, purchase orders, vendor catalogs). 	<ol style="list-style-type: none"> 3. The amounts should agree. If there are any differences, the organization should be asked to explain the reason(s) for the discrepancies.

4. If the organization is unable to supply a detailed listing of materials, but rather, proposes broad general categories (e.g., chemicals, office supplies), obtain rationale for project amounts.
5. Determine whether the organization has adjusted actual prices by such offsets as cash discounts, trade discounts, rebates, allowances, etc.
6. If estimates are used (e.g., factor for spoilage, returns to vendors, salvage, anticipated future increases in cost), determine propriety of method used.
7. Determine that like material costs charged directly to the project are not being concurrently treated as indirect costs (e.g., material costs must be treated consistently within the accounting framework of the organization).
8. Determine whether the organization is receiving or has available to it, appropriate Government surplus material, or materials available under GSA Federal Supply Schedule that may be more economical.
9. Determine whether any material is being purchased through "intra-company" transactions.
10. Determine whether the organization has obtained a sufficient number of competitive bids on significant items of material.
4. Rationale should be of sufficient detail so that an evaluation can be made. The cost analyst should endeavor, where possible, to reconstruct a detailed schedule of materials so that prices per unit may be verified to commercial catalogs, trade publications, vendor bids, etc.
5. These offsets reduce the cost of material and, therefore, should be taken into consideration by the organization when proposing material costs.
6. Estimates may be evaluated as to reasonableness as follows:
 - a. Historical data compiled by organization in support of estimates.
 - b. Industry-wide trend data.
 - c. Written statements from vendors verifying estimates.
 - d. Any other approach(es) deemed reasonable and equitable.
7. No project shall have material costs allocated to it as a direct cost if other material costs incurred for the same purpose, in like circumstances, have been included in any indirect cost pool to be allocated to that project.
8. Grant or contract award funds may be used to acquire Federal surplus material. The Customer Service Bureau GSA Regional Office of Federal Supply and Services or the State Agency for Surplus Property are in a position to inform you of the availability of Federal surplus material.
9. This is allowable provided that project is not being charged a profit factor or unreasonable or unnecessary costs.
10. The determination of what constitutes a significant item of material is largely a matter of judgment. However, criteria such as cost per unit may be used.

Obtaining a sufficient number of competitive bids is also a matter of judgment. However, where applicable, more than one bid should be obtained.

V. Source Material

In order to evaluate the reasonableness of proposed materials and supplies, there are numerous sources currently available through major vendors and distributors. Chapter XVII contains the source of some of the scientific catalogs available for use and a brief description of the types of products.

Chapter VII

REVIEW OF EQUIPMENT

I. Introduction

- A. Equipment means tangible personal property having a useful life of more than 2 years and an acquisition cost of \$500 or more per unit. An organization may use its own definition of equipment provided that such definition includes all tangible personal property as defined herein.

Personal property means property of any kind except real property. It may be tangible—having physical existence, or intangible—having no physical existence, such as patents, inventions, and copyrights.

- B. For the purpose of charging equipment costs to Public Health Service (PHS) grants and/or contracts, the cost of a single unit or piece of equipment may include necessary accessories, duty, excise and sales tax, transportation, in-transit insurance, and installation costs, provided these charges are within the organization's policy as costs of equipment.
- C. In reviewing equipment costs, it is important to understand and distinguish between project-specific equipment and general purpose equipment.
1. Project-specific equipment refers to equipment which directly facilitates the purpose of and is an integral part of a grant or contract program, such as laboratory research equipment.
 2. General purpose equipment refers to items, such as office equipment and furnishings, refrigerators and freezers, automatic data processing devices, etc., which are used for other than technical or specialized activities of the program. Specifically, general purpose equipment is defined as equipment that can be used for other than medical, scientific, or research purposes. Typically, these types of costs are reimbursed to the organization through depreciation or use charges included in the indirect cost pool. However, under certain projects, such as health delivery services awards, these types of costs are usually treated as direct costs.

II. Objectives of Review

The objectives of the equipment review are to ascertain that:

- A. The costs proposed for equipment are reasonable in amount.
- B. The same or similar types of equipment are currently unavailable for use on the project.
- C. The equipment is allowable, applicable, and allocable to the project activity.

- D. The organization's equipment management system is adequate to protect the interest of PHS.

III. Areas of Particular Concern

The following is a list of problem areas relative to the charging of equipment costs. The existence of any of these items on a particular project does not necessarily indicate that an award cannot be processed. It does suggest, however, that a problem may exist and that further investigation is warranted.

These problem areas include:

- A. Charging general purpose equipment directly to the project.
- B. Lack of consistent, written policy regarding the types of costs included as equipment charges (e.g., transportation, installation charges.)
- C. Lack of written definition of equipment consistently followed.
- D. Lack of written policy and procedures regarding inventory control in order to identify the kind, amount, location, etc., of equipment.
- E. Inconsistent accounting treatment of equipment costs.
- F. Improper classification of general purpose items such as refrigerators and freezers, and computing and automatic data processing devices as special purpose equipment.

IV. General Guidelines in Reviewing Equipment

The review of equipment costs can be one of the most complex areas, as necessity and availability of equipment within an organization may be difficult to verify. However, as PHS awardees make substantial purchases of equipment each year for use on research projects, its evaluation is very important.

Many major equipment costs can be verified through the use of General Services Administration (GSA) Supply Schedules, which are maintained at GSA regional and headquarters offices. Costs for equipment items which are not indexed in the GSA Supply Schedules can be obtained through commercial catalogs or by contacting the PHS Division of Acquisition Management.

Additionally, recent audit reports should be reviewed to determine whether there is any information relative to the organization's property management policies and procedures which may be helpful in the financial evaluation of project proposals.

V. Detailed Procedures

The following procedures are intended to serve as a guide in the review and evaluation of equipment costs. The extent of the evaluation and the preliminary procedures to be followed prior to the evaluation are discussed in Chapter III, "Preliminary Procedures for Cost Analyses."

3. Determine whether the same or similar type of equipment, or one that may be used for comparable purpose, is currently available in the organization.
 4. Determine that equipment is specifically related to the project and is not of a general purpose.
 5. Compare the cost of significant equipment items proposed on the award application with that shown in GSA or commercial catalogs, vendor bids, or other source data.
 6. Determine whether the equipment is to be used concurrently between two or more organizational activities.
3. Where it is determined that the organization does not have written property management policies or procedures, a certification from the organization that the same or similar equipment is currently unavailable may be necessary.
 4. Generally, only project-specific equipment is allowable as a direct charge to a project. However, the awarding component may allow general purpose equipment to be charged directly if:
 - a. Equipment is specifically related to the project, and the organization consistently treats this type of equipment as a direct charge to all other projects.
 - b. Circumstances indicate that it would be a financial burden not to reimburse the organization for general purpose equipment.
 5. These amounts should agree. If there are any significant differences, the prospective awardee should be asked to explain the reasons for the discrepancies.
 6. If the equipment is to be utilized by many different organizational activities, the organization shall treat this equipment as an indirect cost. However, if the organization historically and consistently treats this type of equipment as a direct cost, it can prorate the costs between two or more activities. Any equitable method or proration that provides consideration to the full use of the equipment is acceptable.

Equipment may be prorated as follows:

- a. Where actual equipment usage and related costs records are available, the amount distributed should be based on such records.
- b. Where such equipment records are unavailable, the amount distributed may be done on total space assigned to the various activities.
- c. Any other method as deemed reasonable and equitable may be used.

7. Determine the availability and acceptability of Government surplus property.
8. Determine that equipment costs are being treated consistently within the accounting system of the organization.
9. If estimates are used (e.g., anticipated future increases in equipment costs), determine propriety of method used.
7. Grant or contract award funds may be used to acquire Federal surplus property. The Customer Service Bureau, GSA Regional Office of Federal Supplies and Services, or the State Agency for Surplus Property are in a position to inform you of the availability of surplus property.
8. No project shall have allocated to it as a direct costs any equipment cost if other equipment costs incurred for the same purpose, in like circumstances, have been included in any indirect cost pool, to be allocated to that project.
9. Future increases in costs may be based on vendors' bids, price quotes, purchase orders, or other similar documents.

Blank Page

Chapter VIII

REVIEW OF SPACE RENTAL

I. Introduction

PHS supported activities are normally performed in facilities owned by the performing organization. The costs of these facilities are generally charged to PHS awards through depreciation or use charges included in the indirect cost pool as provided in the cost principles applicable to the particular type of organization. In some cases, however, the applicant organization may lease or rent facilities since that approach may be more economical or desirable in view of the particular circumstances involved (e.g., projects of short duration where space is not available in owned facilities, specific program objectives or requirements which cannot be realized with owned facilities).

II. Objectives of Review

Rental costs are those costs associated with the use of space. These include, but are not limited to, any incidental service costs such as maintenance, insurance, and applicable taxes. The objectives of the review are to determine that these costs are:

- A. Consistently treated within the accounting system of the organization.
- B. Reasonable in light of such factors as rental costs of comparable facilities and market conditions in the area; the type, life expectancy, condition, and value of the facility leased, options available, and other provisions of the rental agreement.

III. Areas of Particular Concern

The following is a list of problem areas relative to the charging of space rental costs. The existence of any of these items on a particular project does not necessarily indicate that an award cannot be processed. It does suggest, however, that a problem may exist and that the cost analyst should act accordingly.

These problem areas include:

- A. Charging rental costs directly to grants and contracts where identifiable, while simultaneously charging all other rental costs indirectly.
- B. Where rent is being charged directly to a grant or contract using an onsite indirect cost rate. This creates a possible duplication of rent/building depreciation, and operation and maintenance costs.

IV. General Services Administration Guidelines

The General Services Administration (GSA) compiles from time to time schedules detailing average charges per square foot for office space in major, limited, and rural Federal space areas. Such schedules which are published on a yearly basis may be used as general guidelines in estimating reasonableness of proposed rental costs after considering such other factors as rental costs of comparable property market conditions, etc.

V. Detailed Procedures

The following procedures are intended to serve as a guide in the review and evaluation of space rental costs. The extent of the evaluation and the preliminary procedures to be followed prior to the evaluation are discussed in Chapter III, "Preliminary Procedures for Cost Analyses."

<i>Steps</i>	<i>Comments</i>
1. Determine that sufficient data and documentation needed to evaluate space rental costs have been submitted.	1. In order to evaluate adequately the proposed space rental costs, certain background information must be supplied. The following list is not intended to be all inclusive, but rather, to be used as a guide in determining the basic information needed to perform an in-depth review of space rental costs. <ol style="list-style-type: none">A copy of the current lease or rental agreement.Total square footage required to perform the grant/contract.If applicable, a copy of the sale and lease-back agreement.If estimates are used (e.g., anticipated rental increase, change in facility location), obtain data from which estimates were derived.Any other types of information necessary to make an informed judgment.
2. If it is a renewal or continuation grant/contract, determine whether any advance agreements were previously established. If such an agreement exists, determine whether the organization complied with the agreement and its effect on the proposal under review.	2. In prior grant/contract evaluations, advance agreements may have been established to preclude disputes or problems or to help insure more equity in the future. Examples of such agreements applicable to space rental include: <ol style="list-style-type: none">Changes in the organization's accounting system to identify more accurately space rental costs.Performance of special studies or analyses in connection with the development of future proposals (e.g., renting versus purchasing).

3. Determine that the lease or rental agreement is current or will apply during the period in which the award will be performed.

4. Compare the space rental amount proposed on the award application with that shown on the lease or rental agreement.

5. Where possible, compare space rental costs proposed with those set forth in the yearly published GSA schedules for average charges per square foot for office space.

6. If the space in which the award is to be performed is not similar to or costs vary significantly from those shown on the GSA schedules, determine reasonableness of the proposed space rental costs.

7. Determine whether the lease creates a material equity in property.

8. Determine whether a rental agreement has been established under a longterm lease (e.g., cumulative occupancy of more than 5 years).

3. Outdated information may not be applicable to the award proposal.

4. These two amounts should agree. If there are any differences, the grantee or contractor should explain the reasons for the discrepancies.

5. As stated previously, average space rental rates established by GSA may be used as a general guideline in estimating reasonableness of the proposed costs.

In PHS facilities, 135 square feet per person is considered reasonable for general office space needs. Requests for space in excess of 135 square feet per person should be substantiated by the organization.

6. Factors affecting reasonableness of proposed rates include: comparing proposed space costs with those of an organization of similar nature, size, and type, market conditions, condition and value of property, alternatives available, etc.

7. A material equity in the property exists if the lease is noncancelable or is cancelable only upon the occurrence of some remote contingency.

In all cases, rental costs under leases which create a material equity in the leased property are allowable only up to the amount that would be allowed under applicable HHS cost principles had the lessee purchased the property on the date the lease agreement was executed.

8. Rental costs under long term leases are allowable only up to the amount the lessee would be allowed under applicable HHS cost principles had the lessee purchased the property on the date the lease agreement was executed. However, if the lessee can demonstrate that such leasing (a) will result in less cost over the total period in which the property will be utilized, or (b) is clearly necessary in light of the particular circum-

stances involved, the rental costs for the term of the lease may be charged to the grant or contract.

9. Determine whether this is less than an arms-length lease.
 10. Determine whether a sale and lease-back agreement has been negotiated.
 11. Determine that space rental costs are being treated consistently within the accounting framework of the organization.
 12. If space rental costs are being treated as direct charges to the project, determine that, in applying the indirect cost rate, the operation and maintenance, and depreciation/use charge factors have been excluded from the rate.
 13. If estimates are used (e.g., anticipated future increases in rental costs, changes in present facility), determine propriety of method used.
9. Generally, costs of renting facilities are not allowable where one party to the rental agreement is able to control or substantially influence the actions of the other (e.g., organizations under common control through common officers, directors, or members).
 10. A sale and lease-back arrangement is one under which property owned by the lessee organization is sold and leased back from another organization.

If such an agreement exists, determine that the rental does not exceed the amount the organization would have received had legal title to the facilities been vested in it.
 11. If other rental costs incurred for the same purpose, in like circumstances, have been included in any indirect cost pool to be allocated to that project, no project shall have rental costs allocated to it as a direct cost.
 12. Nonprofit Organizations—The appropriate Regional DCA office can advise whether space rental costs were treated as direct or indirect charges in computing the organization's indirect cost rate. If appropriate, DCA can establish an offsite or special indirect cost rate applicable to the project.

Profitmaking Organizations—Similar information can be obtained from the cognizant Federal audit agency or the cost advisory office of the PHS agency responsible for the negotiation of indirect cost rates.
 13. Various bases used for estimating future rental increases include:
 - a. An organization's prior history regarding rental increases.
 - b. Written or oral information from owner, landlord, etc., citing intent to increase rental cost.
 - c. Any other method or approach as deemed reasonable and equitable.

14. If the rented facility will be used for more than just the performance of a grant or contract, determine the propriety of the method of rental allocation to benefiting areas.

14. If rented facilities will be used by many organizational activities, the organization should treat these rented facilities as indirect costs. However, if rent is treated historically and consistently as a direct cost, the organization may make an allocation to benefiting areas as follows:

- a. Where actual space and related cost records are available, the amount distributed should be based on such records.
- b. Where such space records are unavailable, the amount distributed may be allocated on total space assigned to the various activities.
- c. Any other method as deemed reasonable and equitable may be used.

Blank Page

Chapter IX

REVIEW OF OTHER DIRECT COSTS

I. Introduction

This chapter presents guidelines for the review and evaluation of other direct costs. Other direct costs as used in this chapter refer to those costs specifically identified with a project but not previously discussed in this Manual.

II. Objectives of Review

The objectives of the review are to determine whether:

- A. The classification of other direct costs proposed is in accordance with the organization's current accounting system.
- B. The underlying data in support of the estimates are valid, current, and applicable.
- C. Costs are estimated by knowledgeable personnel through acceptable procedures applicable in the circumstances.
- D. All factors which might have a bearing on the validity of the estimated costs have been considered.

III. Types of Other Direct Costs

Costs classified by organizations as other direct costs vary in accordance with the treatment prescribed by their established procedures. These costs generally include among others:

- A. Alterations and renovations.
- B. Subgrants and contracts under grants, and subcontracts (subawards).
- C. Travel.
- D. Automatic data processing.
- E. Consultants.
- F. Meetings and conferences.
- G. Patient Care Costs

IV. Areas of Particular Concern

The following is a list of problem areas which may be found in evaluating other direct costs. The existence of any of these items on a particular project does not indicate that an award cannot be processed. It does suggest, however, that a problem may exist and that further investigation is warranted.

These problem areas include:

- A. Difficulty in many instances within the awardee organization in either understanding or distinguishing between other direct costs and indirect costs.
- B. Charging other direct costs applicable to Government work directly, while charging all other similar costs applicable to non-Government work of the organization indirectly.
- C. Lack of a consistent, written policy regarding the types of charges to be treated as other direct costs.
- D. Inadequate procedures for estimating other direct costs.

V. Procedures

The procedures listed in the following sections of this chapter are intended to serve as guides in the review and evaluation of other direct costs. The extent of the evaluation and the preliminary procedures to be followed prior to the evaluation are discussed in Chapter III, "Preliminary Procedures for Cost Analyses."

A. Alterations and Renovations

Costs for alterations and renovations usually include the costs of physically converting or adapting facilities, as may be specifically required for performance under a grant or contract. This includes such items as floor refinishing, relocation of wall partitions, relocations of existing mechanical systems, etc.

Alteration and renovation costs under grant awards are allowable provided that:

1. The program legislation or implementing regulations or other grant terms do not exclude "alteration and renovation."
2. The awardee is not an individual or a foreign organization.
3. The award is not a conference grant.
4. The building has a useful life consistent with program purposes and is architecturally and structurally suitable for conversion.
5. The alteration and renovation is essential to the project supported by the award.
6. The space involved will actually be occupied by the project.
7. The space is suitable for human occupancy before work is started, except where the alteration and renovation is to make the space suitable for some purpose other than human occupancy (e.g., storage).

8. If the space is leased, evidence is provided that the terms of the lease are compatible with the alteration and renovation proposed.

Amounts proposed for alterations and renovations under a grant during any consecutive 3-year period cannot exceed the lesser of \$100,000 or 25 percent of the total direct costs proposed, unless specifically authorized by PHS.

Additionally, the maximum amount of PHS grant funds that may be applied to any single alteration and renovation project is \$100,000; and for organizations which are required to have an Institutional Prior Approval System (IPAS), not more than \$5,000 of project funds can be rebudgeted for alteration and renovation during a budget period without prior PHS approval.

However, in the case of those organizations not subject to IPAS, the maximum amount of project funds that can be rebudgeted without prior PHS approval is limited to \$1,000.

<i>Steps</i>	<i>Comments</i>
1. Determine whether the type of project being contemplated authorizes the use of funds for alterations and renovations.	1. Certain types of awards restrict the use of funds to salaries and/or stipends only.
2. Determine whether the proposed costs are presented in sufficient detail in the project application.	2. Detailed data concerning proposed costs should include the following: a. A listing of work to be performed. b. Cost details by task or work order contemplated. c. Details as to whether the work will be performed in-house or by outside contractors (e.g., engineers, mechanics).
3. Ascertain that there is a need for the type of work and cost being proposed.	3. A review of the proposed scope of work may readily justify the need for funding of alterations and renovations. However, where such justification is not readily discernible, the evaluator should request an opinion from the Project Officer concerning the need for the proposed renovations and alterations costs.
4. Determine the basis for the preparation of the estimates.	4. The evaluator should ascertain whether the estimate is based on builder's quotes, the applicant's own historical experience for similar work, or in-house "engineering estimates."
5. Request documentation in support of proposed costs.	5. Supporting documentation may include any of the following: a. Quotes from builders. b. Quantitative and pricing factors for "engineering estimates" prepared in-house.

- c. Copies of invoices for similar work performed under other projects.
 - d. Other historical data accumulated by the applicant for similar work previously performed.
 - e. Any other types of information necessary to make an informed judgment.
- 6. Review the reasonableness of the costs proposed.
 - a. Verify costs proposed to quotes received.
 - b. Where costs are based on oral quotes, attempts should be made to have the applicant provide written confirmation of the proposed costs.
 - c. Where costs are based on "engineering estimates," the proposed costs should be compared with those of other similar proposals for reasonableness.
- 7. Determine that like costs incurred under other projects are also being charged directly.
- 8. Where the applicant is unable to provide any documentation in support of the proposed costs, the evaluator may perform alternative procedures.
 - a. Set aside the proposed costs for lack of supporting documentation.
 - b. Reemphasize the need for submission of supporting data.
 - c. Recommend funding of the project exclusive of any costs for which no supporting data has been submitted.
- 6. Reasonableness should be determined by doing the following:
 - a. Where costs are based on current quotes, the analyst should determine the extent of bid solicitation. Generally, the presence of more than one bid obviates the need for extensive tests or reasonableness due to the element of competition involved.
 - b. Instances where the written confirmation is not readily available, it is permissible to confirm the quotes orally, by direct communication with the supplier. However, a written confirmation of the conversation should be requested by the evaluator.
 - c. See comments under 6.a. and b. above.
- 7. The applicant should be consistent in its treatment of the proposed costs. If such items are being charged directly to Government projects, similar costs incurred for the same purpose under non-Government projects should also be charged directly.
- 8. The alternatives may include the following:
 - a. Set aside the proposed costs for lack of supporting documentation.
 - b. Reemphasize the need for submission of supporting data.
 - c. Recommend funding of the project exclusive of any costs for which no supporting data has been submitted.

B. *Subgrants and Contracts Under Grants, and Subcontracts (Subawards)*

Under certain circumstances, a prospective PHS contractor/grantee may find it necessary to award portions of the effort contemplated under the project to another organization. However, the prospective organization, as the primary recipient of PHS funds, must perform a substantive role in carrying out project activities and not merely serve as a conduit for an award to another party.

Although the primary recipient must maintain a substantive role in a project, there may be instances when it would be necessary for a subrecipient to perform certain activities, also of substantive nature. In these instances, the primary recipient must be able to document (1) the reason(s) why it, rather than the ultimate performer of the activity(ies), should be the direct recipient of PHS funds, and (2) the reasonableness of the funds requested.

Consequently, the contractor/grantee has primary responsibility for the costs incurred under the resulting subaward, but PHS retains stewardship responsibilities over the entire contract/grant award. Moreover, as it relates to contracts under grants, such arrangements can only be entered into by the grantee, with the specific approval of the PHS awarding component.

In general, the contractor/grantee should maintain a case file of all pertinent actions concerning each subaward. Further, all subaward proposals should be reviewed by the prospective contractor/grantee prior to submission to PHS for final review and approval.

In performing the review, the evaluator should review data in support of cost or price analyses performed by the prospective contractor/grantee.

<i>Steps</i>	<i>Comments</i>
1. Request from the contractor/grantee data supporting the costs proposed for subgrants and/or contracts under grants, and subcontracts.	1. Detailed data supporting costs proposed should include the following: a. A listing of contractors, subgrantees, and subcontractors scheduled to perform under the prime contract or grant. b. Cost or price proposals in support of each contract/subcontract, etc., with each one listing all cost elements and amounts being proposed. c. Data in support of cost or price analyses performed by the prime contractor/grantee for each subcontract under a grant proposed.
2. Evaluate the reasonableness of the costs proposed.	2. The evaluator should: a. Review the cost or price analysis performed by the recipient of the PHS award. All significant cost elements listed in the proposal should be tested. Steps delineated in the appropriate chapters elsewhere in this Manual should be used in testing all significant cost elements.

- b. Ensure that a breakdown of and justification for the estimated costs was provided, including the manner in which indirect costs will be reimbursed.
 - c. Ensure that indirect costs budgeted for both the subrecipient and the applicant organization are not excessive and would not result in duplicate or unreasonable charges.
3. Where the PHS contractor/grantee has not performed cost or price evaluations of the proposed subcontract(s), etc., the PHS evaluator should perform an evaluation of the proposal(s) using the guidelines discussed elsewhere in the Manual, with respect to labor, material, and other direct and indirect costs.
 4. Ascertain that profit or fee factors included in the subcontract or contract under grant proposals are reasonable.
 4. Ensure that the maximum profit or fee proposed is the percentage allowed by statute or regulation (see HHS Acquisition Manual Part 315.900 and Federal Acquisition Regulation Manual (FAR) 15.903(d)).
 5. See step 8, under section "Alterations and Renovations" of this chapter.

C. *Travel*

Travel costs are allowable where such travel will provide direct benefit to the program being supported. Travel costs usually include the costs of transportation, lodging, meals, and incidental expenses incurred by personnel while on official business. Usually, travel and subsistence estimates are based on the contemplated number of trips, places to be visited, length of stay, transportation costs, and subsistence allowances. However, travel costs proposed by contractors, including per diem rates, should not exceed those provided by the Federal Travel Regulations (FTR). In addition, the costs of transporting patients to the site where services are being provided, including public transportation, are also allowable.

Steps

Comments

- | | |
|--|---|
| <ol style="list-style-type: none"> 1. Determine whether proposed costs are presented in sufficient detail in the project application. | <ol style="list-style-type: none"> 1. Supporting data concerning travel costs should include the following: <ul style="list-style-type: none"> a. Number of trips planned. b. Cost per trip per person. c. Destination(s) proposed and duration of trip(s). d. Number of travelers per trip. e. List of individuals proposed for the trips. f. Mode of transportation and proposed fare per trip. |
|--|---|

- g. Mileage allowances if privately owned vehicles will be used.
 - h. Subsistence rate per day (per diem).
 - i. Other incidental data supporting the proposed costs.
2. If necessary, request additional documentation in support of proposed costs.
 3. Determine whether the applicant organization has written travel policies.
 4. Determine whether the proposed costs are consistent with organizational travel policies.
 5. Ensure that commercial transportation costs have been proposed at less than first class rate.
 6. Test the reasonableness of proposed car rental costs.
 7. Determine the acceptability of the proposed subsistence costs.
 8. Evaluate the reasonableness of proposed mileage allowances for the use of personal cars.
2. See comments under 1. above.
 3. Where the applicant has no formal travel policies, HHS travel regulations shall apply in determining the travel costs chargeable to project funds.
 4. Any deviations between costs proposed and those allowable in accordance with established organizational policies should be adequately explained.
 5. In accordance with PHS policy, commercial transportation costs must be proposed at less than first class whenever available.
 6. Car rental allowances should be proposed at the most economical rates available. If the organization is entitled to car rental discounts, proposed costs should be duly adjusted.
 7. Where the established organizational travel policy allows for the reimbursement of actual costs incurred, and the proposed costs appear to be excessive, the cost evaluator may deem it appropriate to recommend that certain reimbursement limitations be incorporated into the grant award document.

Where subsistence costs are based on daily rates, reasonableness may be determined by comparing the proposed rates with those of other grantees, those cited in Internal Revenue Service guidelines, the maximum per diem rate authorized by the Federal Government in the locality in which the travel is performed, etc.
 8. Mileage allowances estimated for the use of personal cars should not exceed reasonable limits. Where appropriate, car pooling should be considered in lieu of use of multiple vehicles.

9. See step 8. under section "Alterations and Renovations" of this chapter.

D. *Automatic Data Processing*

These costs are normally incurred by organizations for the use of highly mechanized systems for data processing. Organizations may possess in-house capability or may rely on outside services for the utilization of Automatic Data Processing Systems (ADPS).

<i>Steps</i>	<i>Comments</i>
1. Determine whether proposed costs are presented in sufficient detail in the project application.	1. Detailed data concerning proposed costs should include the following: <ol style="list-style-type: none">a. Types of equipment which will be used; personal computers, word processors, remote terminals, central processor unit, input-output components, etc.b. Usage hourly rates for the types of proposed equipment.c. Estimated use time for each type of equipment.
2. Request documentation in support of proposed costs.	2. Supporting documentation may include any of the following: <ol style="list-style-type: none">a. Listing of rates or quotes from prospective suppliers of ADPS.b. Copies of invoices submitted by past suppliers of the applicant.c. Where the applicant has in-house ADPS capability, listing of rates developed and/or approved by a Government agency.
3. Evaluate the reasonableness of the costs being proposed.	3. The evaluator should: <ol style="list-style-type: none">a. Verify proposed rates with those on listings or quotes obtained by the applicant.b. Where there are no listings or quotes available, the evaluator may find it practical to verify the proposed rates with the prospective suppliers either by telephone or in writing.c. In the case of nonprofit organizations where the proposed rates have not been approved by a Federal agency, the appropriate Regional DCA office should be requested to review, and express an opinion on, the reasonableness of such rates. For profitmaking organizations, similar cooperation may be requested from the cost advisory office of the PHS agency sponsoring the project.

4. See step 8. under section "Alterations and Renovations" of this chapter.

E. *Consultants*

These costs are incurred by an organization in obtaining outside services provided by experts or specialists in other fields of activity. A consultant acts as an advisor or expert to an organization as distinguished from an employee who carries out the organization's duties and responsibilities.

The use of PHS funds for the payment of fees to consultants (from both within and outside the organization) is allowable under the following conditions:

- a. The consultants' services are essential and cannot be provided by persons receiving salary support under the project or other compensation for their services.
- b. A selection process approved by a senior officer of the organization has been used to secure the most qualified person available.
- c. Charges for services are appropriate considering the qualification of the consultants, their normal charges, and the nature of the services rendered.

Under the following circumstances, educational institutions may use the services of their own employees as consulting effort under the proposed project.

- a. The consultation is across departmental lines or involves a separate or remote operation.
- a. The work performed by the consultant is in addition to his or her regular departmental workload.

Consultant charges to a project may include fees, travel, and subsistence costs where applicable.

Consultant fees are not generally paid to an employee of the Federal Government, except for services provided by medical personnel of the Uniformed Services of the U.S. (excluding PHS Commissioned Officers), and then only under specific conditions.

Steps

Comments

- | | |
|---|---|
| <ol style="list-style-type: none">1. Ascertain the need for the type of service(s) being contemplated.2. Determine whether the proposed costs are presented in sufficient detail in the project application. | <ol style="list-style-type: none">1. Generally, consulting services may be justified when the organization does not have the expertise being sought from the consultants.2. Detailed data concerning the proposed costs should include the following:<ol style="list-style-type: none">a. Name(s) of consultant(s) to be engaged.b. Daily fees to be paid to each consultant.c. Number of estimated days of continuing services.d. Scope of work to be performed.e. Other incidental data supporting the proposed costs. |
|---|---|

3. Request documentation in support of the proposed costs.
 4. Evaluate the reasonableness of the costs being proposed.
 5. Determine that no employees of the organization are being proposed as consultants to the project.
 6. Determine whether fringe benefit costs have been applied to proposed consultants' costs.
 7. Determine whether indirect costs have been applied to proposed consultants' costs.
3. Supporting documentation may include the following:
 - a. Consulting agreements entered into/between consultant(s) and the organization.
 - b. Invoices submitted by consultants for similar services previously provided to the organization.
 - c. Educational institution's policy which authorizes the use of its employees as consultants.
 4. Generally, the fees being proposed by consultants are based on the degrees of expertise that each individual possesses in the field in which the services are to be provided.

The determination of what constitutes a reasonable cost is largely a matter of judgment.

 - a. Verify proposed rates with those listed in "Consulting Agreements" entered into/between the organization and the consultant(s).
 - b. If consultants have been used previously by the organization, compare proposed rates with those appearing on previous invoices for services rendered by the consultants to the organization.
 5. Employees of the organization submitting the proposal may not perform as consultants to the project, except in the case of educational institutions. See this section's introductory remarks for allowability criteria.
 6. Fringe benefits should not be applied to consultants' costs since consultants generally are not employees of the organization.
 7. Indirect costs should not be applied to consultants' costs unless the distribution basis is total direct costs, or such other basis which would include consultants' costs.

F. *Meetings and Conferences*

These are costs incurred to defray the expense of attendance at meetings by personnel of the organization.

Steps

1. Determine whether the proposed costs are presented in sufficient detail in the project application.
2. Determine whether there is a direct relationship between attendance at the meetings and the work to be performed under the project.
3. Request documentation in support of proposed costs.
4. Evaluate the reasonableness of the proposed costs.
5. See step 8. under section "Alterations and Renovations" of this chapter.

Comments

1. Detailed data concerning costs proposed should include the following:
 - a. Individuals scheduled for attendance at the meetings if available.
 - b. Meetings to be attended, duration, location, etc.
 - c. Registration fees for each individual attending.
 - d. Transportation costs (mode, fare, type of accomodation, per diem, etc.).
 - e. Other costs such as room rentals, equipment rentals, printing and postage, honoraria, etc.

2. Costs of attending meetings and conferences should be allowed as direct costs when there is a direct benefit accruing to the project. Otherwise, such costs should be treated as indirect costs of the applicant organization.

Questions regarding the applicability of such costs should be referred to the PHS Project Officer for determination.

3. See comments under 1. above.
4. The evaluator should:
 - a. Verify proposed costs to supporting data.
 - b. Ensure that registration fee costs do not exceed those for Federal Government employees or most favored participants.
 - c. Ensure that transportation costs are proposed at less than first class rates.
 - d. Ensure that per diem rates do not exceed maximum authorized by the Federal Government for the locality in which the travel occurs.
 - e. Ensure that where subsistence costs which are based on actual expenses incurred appear to be excessive, certain cost limitations are incorporated into the grant or contract document.

G. Patient Care Costs

Patient care costs are allowable for reimbursement under PHS awards only when such costs are (1) approved in the initial award budget, or (2) approved in a subsequent written authorization by the PHS awarding agency. In many cases, patient care cost rates for routine and ancillary services may already be established by the appropriate Regional Division of Cost Allocation (DCA). Accordingly, the DCA office should be contacted to determine what costing data is already available and to obtain any other background information which may be needed for the review and evaluation of the budget proposal.

The following steps are intended to aid the cost evaluator in the review of patient care costs. Since the extent of the review and the procedures to be followed may vary for each organization, the cost evaluator may use at his/her discretion additional guidance provided in GAM Part PHS: 604 "Research Patient Care Costs," and the "PHS Grants Policy Statement."

<i>Steps</i>	<i>Comments</i>
1. Ascertain that there is a need for the type of costs being proposed.	1. A review of the proposed scope of work may readily justify the need for funding patient care costs. However, where such justification is not readily discernible, the evaluator should request an opinion from the Project Officer concerning the need for the proposed costs.
2. Determine if proposed patient care costs are presented in sufficient detail in the proposal.	2. Supporting data should include: a. Routine patient care costs. – Number of proposed patient days. – Daily (scatter-bed) rates (total inpatient routine costs divided by routine patient days). – Proposed patient care costs (number of proposed days time daily rate). b. Outpatient care costs. – Proposed outpatient charges. – Cost conversion factor (ratio of costs to charges for outpatient cost center). – Proposed outpatient costs (outpatient charges times cost conversion factor). c. Ancillary Costs – Proposed number and type of each ancillary service. – Cost conversion factor for each ancillary service (ratio of cost to charges for each ancillary service included in proposal). – Proposed cost for each type of ancillary service (number of instances service is to be obtained times charge for each service times cost conversion factor).

3. Determine whether special costs are reported separately in the proposal.
 4. Evaluate the reasonableness of the costs proposed.
 5. Determine if Medicare cost reimbursement policies are followed.
3. In some cases, a budget may contain direct "line items" (such as special nursing care or dietary services) to meet the special needs or demands of patients covered by an award. If the "line item" services are included in the computation of various rates, adjustments to certain rates (e.g., routine patient care daily rate) may be needed to eliminate duplication of charges.
 4. The evaluator should ascertain whether:
 - a. There is a negotiated patient care rate(s) agreement with DCA if the organization's patient care costs are \$25,000 or more on any single award including funds to sub-awardee organizations.
 - b. There is a procedure for establishing which costs are usual patient care costs and which are research patient costs.
 - c. There is a policy for adjusting charges when patient care costs are funded through PHS research projects.
 - d. Research patient costs charged to PHS are not charged to third-party organizations.
 - e. There is a policy for reimbursing the Government for patient care costs initially charged to research projects but subsequently paid by third-parties.
 5. The evaluator should:
 - a. Review the appropriate sections of the Medicare cost report to determine:
 - Daily routine patient care rate.
 - Cost conversion factors for outpatient and ancillary services.
 - b. Obtain justification for differences between the Medicare cost report rates and the proposed costs.
 - Determine if any audit adjustments have been made to the cost reports, if appropriate.
 - c. Review allocation procedures and step-down schedules when a Medicare cost report is not available to determine how the daily routine patient care rate and cost conversion factors for outpatient and ancillary services were computed.
 - This verification would ensure that general service costs are allocated to direct cost centers (e.g., patient care, research) based on a ratio of services provided.

Blank Page

Chapter X

REVIEW OF INDIRECT COSTS

I. Introduction

- A. Indirect Costs—Indirect costs are those costs not readily identified with a project or any other organizational activity, but rather, incurred by an organization—as in the operation and maintenance of buildings or in the payment of utilities costs or administrative salaries—for the joint benefit of the project and of other objectives. Such costs are usually grouped into common pools and charged to benefiting objectives through an allocation process.
- B. Indirect Cost Rates—In theory, all costs might be charged directly. Practical difficulties, however, preclude such an approach. Accordingly, an indirect cost rate is simply a device for determining fairly and expeditiously the proportion of such general expenses that each project shall bear.

The indirect cost rate is the ratio between the total indirect expenses of an organization and some direct cost base, commonly either salaries and wages or total direct costs or modification thereof.

II. Costs Normally Included in the Indirect Pool

The following is a partial list of costs normally included as part of the indirect pool.

A. Personal Services

- | | |
|---------------------------------|--|
| 1. Administration | Executive director, department heads, assistants, and other member of their staffs. |
| 2. Personnel | Personnel director, personnel specialists, other staff of the personnel department. |
| 3. Accounting | Comptroller, chief accountant, accountants, bookkeepers, etc. |
| 4. Procurement | Purchasing officer, procurement analysts, procurement clerks, property control clerks, stockroom employees, etc. |
| 5. Housekeeping and Maintenance | Custodial and janitorial, facility engineers, maintenance, and repairmen, groundskeepers, etc. |
| 6. Legal | General counsel, lawyers, law clerks, etc. |

7. Library	Librarian and other library staff.
8. Automatic Data Processing	Director, programmers, operators, other ADP staff, etc.
 B. Other Costs	
1. Space Rental	Office, laboratory, storage, space, etc.
2. Utilities	Heat, light, etc.
3. Communication	Local telephone charges, installation costs, etc.
4. Taxes	Real estate, State income, franchise, etc.
5. Insurance	Fire, liability, casualty.
6. Materials, Supplies, Travel	Associated with performance of duties of the categories of personal services shown above.

III. Necessity for an Indirect Cost Rate

Since 1967, the Public Health Service has supported the policy of paying full indirect costs applicable to its programs. Legislative limitations or budgetary constraints, however, may limit the recovery of indirect costs. For example, indirect costs on training grants are limited to the lesser of the organization's actual indirect costs exclusive of tuition and related fees and expenditures for equipment or 8 percent of total allowable direct costs. The same is applicable for Research (Career) Development Awards. Other programs may carry similar limitations, either administrative or statutory.

Notwithstanding these administrative or statutory limitations, it is generally necessary for most organizations to establish an indirect cost rate if they are to be reimbursed for indirect costs. There are, however, situations in which organizations will be reimbursed for indirect costs without an established indirect cost rate.

These instances are as follows:

- A. The particular award is the sole source of funding to the organization.
- B. The organization appropriately and consistently treats all charges as direct costs and can properly account for them as such.

IV. Application of Indirect Cost Rates

The purpose of this section is to provide guidance in evaluating whether a proposed indirect cost rate is applicable to a given project. Normally, a single indirect cost rate is applicable to all projects conducted by an organization. There are instances, however, when the organization proposes, or the costs analyst determines, that the use of a single rate would result in a grossly inequitable distribution of costs. The circumstances under which a single indirect cost rate may not apply and therefore would require an offsite, discrete, or special rate include:

- A. Offsite Indirect Cost Rate—The need for an offsite or offcampus rate is evidenced when the activity is conducted at a location other than on the organization's premises, and in-

direct costs associated with the organization's facilities, such as operation and maintenance of plant and depreciation/use charges, are not applicable to the activity.

- B. **Special or Discrete Indirect Cost Rates**—Special or discrete rates may be required where the project being funded is essentially an autonomous operation and, therefore, will receive little or no benefit from the organization's indirect activities. This becomes evident from the fact that the project will fund as direct costs all or most of the types of services usually supplied as indirect (e.g., general administration, procurement, accounting, personnel functions, operation and maintenance of plant). Special rates may also be required where the volume of activity to which the special rate would apply is material in relation to other activities at the organization. Furthermore, special indirect cost rates will be established when a program's authorizing legislation imposes restrictions on the reimbursement of certain types of indirect costs that would otherwise be properly allocable to the project.

If it is determined that an offsite, special, or discrete rate is needed at a nonprofit organization, and one has not been established, the cost evaluator should contact the appropriate Regional Division of Cost Allocation (DCA) office to explain the necessity for such a rate and request its establishment.

In the case of profitmaking organizations, the cognizant audit agency should be contacted. Centralized programs may also avail themselves of cost advisory services. Where these options are not available, the cost evaluator may be required on his/her own to establish a discrete or special indirect cost rate.

V. Objectives of the Indirect Cost Review

The objectives of the indirect cost review are to ascertain whether: (a) a rate is needed, (b) the organization has a current rate established with HHS, (c) the rate used is appropriate to the particular activity, (d) a special rate is necessary and/or the rate is then applied to the correct distribution base.

VI. Areas of Particular Concern

The following is a list of problem areas relative to the charging of indirect costs. The existence of any of these items on a particular project does not necessarily indicate that an award cannot be processed. It does suggest, however, that a problem may exist and that further investigation is warranted.

These problem areas include:

- A. Direct charging of normal indirect costs (e.g., business office manager, comptroller, rent).
- B. Inconsistent treatment of certain items as direct or indirect costs (e.g., fringe benefits, toll charges on long distance calls, equipment purchases).
- C. Incorrect application of indirect cost rates (e.g., applying an onsite indirect cost rate to an offsite activity).
- D. Applying the indirect cost rate to an incorrect allocation base (e.g., applying an indirect cost rate developed on a salaries and wages base to the total direct costs of a project).

VII. Detailed Procedures

The following procedures are intended to serve as a guide in the review and evaluation of indirect costs. The extent of the evaluation and the preliminary procedures to be followed prior to the evaluation are discussed in Chapter III, "Preliminary Procedures for Cost Analyses."

<i>Steps</i>	<i>Comments</i>
1. Determine whether an indirect cost rate is necessary.	1. It is generally necessary for most organizations to establish an indirect cost rate to obtain reimbursement for indirect costs applicable to PHS supported projects. Some exceptions to this rule are as follows: a. The award is the sole source of funding to the organization. b. The organization consistently treats all charges as direct costs and can properly account for them as such. c. The award is subject to certain statutory or administrative restrictions which prohibit the payment of indirect costs. d. The award is a training grant to other than a State or local government agency. e. The organization voluntarily waives reimbursement of indirect costs.
2. Determine whether the institution has a currently effective indirect cost rate established with HHS or another Federal agency.	2. Organizations which claim indirect costs can generally only be reimbursed indirect costs when they are appropriately supported by a currently effective indirect cost rate. All organizations other than profitmaking organizations, which do not have a current negotiated rate, must submit an indirect cost proposal to the appropriate Regional DCA office. Organizations which have not negotiated an indirect cost rate prior to receipt of an award may be funded at an initial amount of 50 percent of the proposed indirect costs or 10 percent of salaries and wages, whichever is the lesser, until a rate is established. Indirect cost rates with another Federal agency will normally be recognized by HHS provided such rates are published by the HHS Office of Procurement, Assistance, and Logistics (OPAL), OS, Office of the Assistant Secretary for Management and Budget, formerly known as the Office of Grant and Contract Financial Management.

In those instances where an award is being made to a profit organization, any questions concerning the propriety of the indirect cost rate(s) proposed should be referred to the

appropriate cost advisory staff of the PHS agency administering the project. (A listing of these offices is contained in Chapter II, "Responsibility for Financial Evaluations,") Where it is deemed appropriate by the cost evaluator, indirect cost rates negotiated by another Federal agency may be acceptable.

3. Determine whether the organization has applied the indirect cost rate to the proper "rate location."
 4. Determine that the organization has applied the indirect cost rate to the proper distribution base.
 5. Determine whether an offsite, special, or discrete indirect cost rate is appropriate.
3. Normally, a single indirect cost rate is established which is applicable to all projects conducted by the organization. However, offsite or discrete rates are established if applicable. The application of indirect cost rates is discussed more fully in section IV of this chapter.
 4. Typical distribution bases include:
 - a. Salaries and wages including vacation, holiday, and sick leave, but excluding all other fringe benefits.
 - b. Salaries and wages including all fringe benefits.
 - c. Total direct costs less major renovations and alterations, subcontracts, and equipment.
 5. Offsite and other special indirect cost rates will be established only when all of the following conditions are present:
 - a. An activity is conducted in a physical or administrative environment that generates a significantly different level of indirect costs than the other activities of the organization.
 - b. The special rate(s) would be substantially lower or higher than the rate(s) applicable to other activities.
 - c. The rate(s) would apply to a material amount of federally supported direct costs.

Therefore, the indirect cost rate must be applied only to those costs on which it was developed. For example, if the indirect cost rate was established based on salaries and wages including all fringe benefits, the indirect cost rate can only be applied to proposed personnel costs including all fringe benefits.

The need for offsite, special, or discrete indirect cost rates are discussed more fully in Section IV of this chapter.

6. Determine whether the organization is charging directly to the project such items of costs that are normally treated as indirect (e.g., heat, light, rent, general and administrative expenses).
7. Determine that the organization is consistently treating the costing of such items as fringe benefits, equipment, materials, long-distance toll calls, ADP, etc.
6. This is not necessarily incorrect provided:
 - a. The award is the sole source of funding to the organization.
 - b. The organization consistently treats all such charges as direct costs and can properly account for them as such.
 - c. A special or discrete indirect cost rate has or is being established.
7. These types of charges can easily be treated as indirect or direct costs depending on the organization's accounting system. Either method selected by the organization is acceptable provided it is followed consistently. For example, it would be unacceptable to charge fringe benefits applicable to a Government project directly while charging all non-Government fringe benefits to indirect costs. Refer to the applicable chapters in this Manual for additional guidance.

VIII. Obtaining Indirect Cost Information for Nonprofit Organizations

Indirect cost rates for all organizations other than profitmaking organizations are established by negotiations between the appropriate Regional DCA office and each applicant organization based upon an indirect cost rate proposal submitted by the organization. The rates are disseminated by DCA, through OPAL to operating personnel involved in the award or settlement of grants and contracts via published Negotiation Agreements.

- A. Indirect Cost Rate Register – The initial source for indirect cost information is the Indirect Cost Rate Register. In addition to listing the latest applicable negotiation agreements by organization, location, and date, it details which organizations are delinquent in the submission of indirect cost rate proposals and those organizations which have had indirect cost rates established in the past but currently have no activity.
- B. Negotiation Agreements – Negotiation Agreements issued by DCA are disseminated to Cost Advisory Staffs and Grants Management Staffs to PHS through OPAL. The Negotiation Agreement is the prime document for obtaining indirect cost rate information. As such, these agreements contain the following pertinent information.
 1. The type of rate negotiated (e.g., provisional, final, fixed, or predetermined). (See GAM Part PHS: 606, "Establishment of Indirect Cost Rates.")
 2. The period of time to which the rate applies.
 3. The rate – the rate reflects the allowable indirect expenses of the organization expressed as a percentage of the direct cost base to which it applies. Some organizations have two or more rates. In such instances, the location or programs to which each rate applies will be indicated to the extent appropriate. (See GAM Part PHS: 609, "Reimbursement of Indirect Costs.")
 4. The rate base (e.g., the appropriate direct costs to which the rate is to be applied). This is usually direct labor or total direct costs or modifications thereof.

5. The location(s) to which the rate applies. GAM Part PHS: 609, "Reimbursement of Indirect Costs," contains explanations and instructions for the application of rates used in agreements in accordance with the appropriate location designation.
 6. The type(s) of programs (e.g., research, health delivery services) to which the rate applies.
 7. The treatment of fringe benefits (direct or indirect).
- C. PHS Cost Advisory Staffs—Currently, each of the five operating agencies within PHS has cost advisory personnel which serve as the focal point for indirect cost rate information. These offices receive both negotiation agreements and the Indirect Cost Rate Register issued by OPAL, and also negotiate indirect cost rates with profitmaking organizations (see Section IX below). Consequently, they can advise all headquarters' personnel within PHS on indirect cost rate matters. These cost advisory staffs are listed in Chapter II, "Responsibility for Financial Evaluations."
- D. HHS Division of Cost Allocation—The Divisions of Cost Allocation have the responsibility for negotiating indirect cost rates with nonprofit organizations. Regional staffs may direct all inquiries involving indirect costs for nonprofit organizations to the divisions listed below.

**HHS REGIONAL ADMINISTRATIVE SUPPORT CENTERS
DIVISION OF COST ALLOCATION**

<i>Region</i>	<i>Address</i>	<i>Telephone</i>	<i>For Grantees Located</i>
I	Director Division of Cost Allocation John Fitzgerald Kennedy Federal Building Government Center Boston, Massachusetts 02203	FTS 223-5181	Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, Vermont
II	Director Division of Cost Allocation Jacob K. Javits Federal Building 26 Federal Plaza New York, New York, 10278	FTS 264-4300	New Jersey, New York, Canada, Puerto Rico, Virgin Islands, England, Beirut
III	Director Division of Cost Allocation Federal Office Building 3535 Market Street P.O. Box 13716 Philadelphia, Pennsylvania 19101	FTS 596-0149	Delaware, Maryland, Pennsylvania, Washington, D.C., West Virginia, Virginia
IV	Director Division of Cost Allocation 101 Marietta Tower Atlanta, Georgia 30323	FTS 242-2455	Alabama, Florida, Georgia, Kentucky, Mississippi, North Carolina, South Carolina, Tennessee

V	Director Division of Cost Allocation Federal Office Building 300 South Wacker Drive Chicago, Illinois 60606	FTS 353-8330	Illinois, Indiana, Michigan, Minnesota, Ohio, Wisconsin
VI	Director Division of Cost Allocation Federal Office Building 1200 Main Tower Dallas, Texas 75202	FTS 729-3261	Akansas, Louisiana, Texas, New Mexico, Oklahoma
VII	Director Division of Cost Allocation Federal Office Building 601 East 12th Street Kansas City, Missouri 64106	FTS 758-2304	Iowa, Kansas, Missouri, Nebraska
VIII	Director Division of Cost Allocation Federal Office Building 1961 Stout Street Denver, Colorado 80294	FTS 564-5566	Colorado, Montana, North Dakota, South Dakota, Utah, Wyoming
IX	Director Division of Cost Allocation Federal Office Building 50 United Nations Plaza San Francisco, California 94102	FTS 556-1704	American Samoa, Arizona, California, Guam, Hawaii, Nevada, Trust Territory of Pacific Islands, Northern Mariannas
X	Director Division of Cost Allocation The Third and Broad Building 2901 3rd Avenue Seattle, Washington 98121	FTS 399-4390	Alaska, Idaho, Oregon, Washington

IX. Obtaining Indirect Cost Information for Profitmaking Organizations

Indirect cost rates for profitmaking organizations may be established by cost advisory personnel located within each of the HHS operating components.

Where it has been determined that the organization has a currently effective indirect cost rate established with another Federal agency, the cost evaluator, at his/her discretion, may use such a rate.

Chapter XI

REVIEW OF MATCHING AND COST PARTICIPATION UNDER PHS AWARDS

I. Introduction

Recipient matching contributions expressed as a percentage of project costs are required by certain awards' program legislation or regulation.

Recipients' cost participation contributions, which some consider similar to matching, may be required as a result of programmatic or administrative decisions.

The users of the Manual should refer to the PHS Grants Policy Statement, the PHS Grants Administration Manual (GAM), and 45 CFR Part 74, Subpart G, as appropriate, for detailed information on matching and cost participation requirements under PHS grants. In the case of contracts, users of the Manual should refer to the HHS Acquisition Regulations, Part 335.

II. Ways of Providing Contributions

Institutions may provide their matching and/or cost participation contributions in any of the following ways:

1. *Cash Contributions*

By contributing from non-PHS funds some or all of the costs of an activity or activities applicable to PHS projects, i.e., institutional fund contributions, including cash contributed to the grantee/contractor by individuals or other private organizations.

2. *In-Kind Contributions*

By the application of the value of non-Federal third-party in-kind contributions made directly to, and used in the project(s) supported with PHS funds. In-kind contributions may consist of donated time and effort, real and nonexpendable personal property, and goods and services directly benefitting and specifically identifiable to the PHS supported activity or activities.

3. *Program Income*

By the application of grant-related or program income, other than income from certain royalties and from the sale of real or tangible personal property, to the project supported with PHS funds. This is allowable only when the terms of the award expressly permit such use.

4. *Combination of Non-Federal Sources*

By contributions from a combination of any of the three methods described above.

III. Detailed Procedures

The following procedures are intended to provide guidance in the review of proposed matching and/or cost participation contributions.

<i>Steps</i>	<i>Comments</i>
1. Ascertain whether matching and/or cost participation should be provided under the grant or contract proposal submitted.	1. This may be done through a review of the PHS program requirements.
2. Ascertain whether the proposed matching and/or cost participation contributions comply with the PHS program requirements	2. The evaluator should ensure that the (i) proposed matching or cost participation costs are included as part of the project budget, and (ii) total amount or rate to be provided is in compliance with the applicable requirements.
3. Determine how the recipient proposes to satisfy the matching and/or cost participation requirements.	3. The proposal would state how the contributions will be made, i.e., a reduction of indirect costs, indirect costs, or total proposed costs. Further, it should state whether the contributions will be made by the applicant, third-parties, or both.
4. Determine the propriety of the proposed matching or cost contributions. a. Applicant in-kind contributions.	4. a. Personnel or other direct costs to be contributed should be based on the salaries to be paid to the individuals involved or costs to be incurred for the other items to be provided. The valuation of real or tangible personal property to be contributed should be based on the costs recorded on the organization's books of account. The valuation of indirect costs to be contributed should be based on a reduction of the amount which the organization would otherwise be entitled to.
b. Third-party in-kind contributions.	b. The value assigned to effort contributed by third-party sources should be commensurate with the salary costs which otherwise would be paid to the individual or individuals involved. If the data is not available, a comparison with salaries paid by other organizations doing similar work in the same geographic location may prove useful. The valuation of real or tangible personal property donated by third-parties should be based on their fair market value.

Chapter XII

REVIEW OF PROGRAM OR GRANT-RELATED INCOME

I. Introduction

Program or grant-related income is defined as gross revenues earned by recipient organizations from activities in which the costs are borne by (1) an HHS supported project, or (2) a matching or cost participation requirement of the project. It includes, but is not limited to, income such as fees for services performed, proceeds from sale of tangible personal or real property, use fees or rental fees, patent or copyright royalties, third-party reimbursements, etc.

Records of earnings, receipts, and disposition of program income or grant-related income for which the organization is accountable must be maintained in the same manner as required for the funds that gave rise to the income.

II. Objectives of the Review

The objectives of the program or grant-related income review are to ascertain that:

- A. Income retained by the grantee will be used in accordance with the requirements of CFR 45 Part 74, Subpart F, and the terms of the grant award or applicable program legislation, e.g., sections 329 and 330 of the PHS Act.
- B. The organization maintains a formal system to account for program or grant-related income.
- C. The organization has a system to account for the proper disposition of program or grant-related income.
- D. The proposed amount of program or grant-related income is reasonable.

III. Areas of Particular Concern

The following is a list of problem areas relative to the reporting and accounting for program or grant-related income. The existence of any of these items on a particular project does not necessarily indicate that an award cannot be processed. It does suggest, however, that a problem may exist and that the cost analyst should act accordingly.

These problem areas include:

- A. Lack of written policy and procedures regarding program or grant-related income and its disposition.
- B. Lack of a system to record and/or report income derived from program activities supported by HHS awards.

- C. Lack of consistent documentation of program or grant-related income earned and/or expended.

IV. Detailed Procedures.

The following procedures are intended to serve as a guide in the review of program or grant-related income. Such steps will aid in determining whether a system to account for program or grant-related income has been established, and whether the amount proposed is reasonable. Additional guidance is provided in the "PHS Grants Policy Statement."

A. Evaluation of System

<i>Steps</i>	<i>Comments</i>
1. Determine whether the organization has written policies and procedures relating to program or grant-related income.	1. Obtain a copy of the organization's written policies and procedures. Where there are no written policies and procedures, obtain a description of the practices in use and request that policies and procedures be formally issued.
2. Evaluate the adequacy of the organization's policies and procedures.	2. Desirable features of adequate program or grant-related income policies and procedures include: <ul style="list-style-type: none"> a. A management system to adequately identify the income for each Government project. b. Records showing earnings, receipts, and disposition of the income for which the organization is accountable should be maintained by the recipients in the same manner as required for the funds that gave rise to the income. (An exception is the additional cost alternative—45 CFR 74.42e.) c. Establishment of accounts for recording the type of income producing services (e.g., vocational rehabilitation grants, selling services, special testing or computer resources, third-party reimbursements, and patient diagnostic and/or treatment).
3. Determine if the organization has a system to account for the proper disposition of program or grant-related income.	3. This should include the proceeds of any income from patients, third-party payors, and income earned from royalties, copyrights and copyrighted materials, patents or inventions, interest, sale of real or tangible property, use fees, etc.

All program or grant-related income should be used or disposed of in accordance with 45 CFR Part 74, Subpart F. Interest or investment income earned on advances of grant funds (except for State entities) is to be remitted to PHS. General program income is retained by the recipient and used in accordance with one or a combination of three alternatives as prescribed by 45 CFR Part 74, Subpart F.

B. Evaluation of Projected Income

<i>Steps</i>	<i>Comments</i>
1. Determine that sufficient data and documentation needed to evaluate program income have been submitted.	1. The proposal should include the following. <ol style="list-style-type: none">a. A listing of program income sources, i.e., Medicare, Medicaid and other third-party sources, patients' fees.b. The basis used in estimating projected program income, i.e., catchment area population, patients to be attended, patients' ability to pay, third-party coverage.
2. Determine the reasonableness of program income projections.	2. This may be accomplished as follows: <ol style="list-style-type: none">a. <i>New Project</i> – Compare projections against experience by other similar organizations within the same geographical area providing the same or like services.b. <i>Renewal or Continuation Project</i> – Compare projections against the organization's previous years' experience as reported on financial status reports, financial statements, etc.

If projections are considerably less than the organization's previous experience, ascertain and evaluate the propriety of such difference. Projections may also be compared against other like organizations' experience.

Blank Page

Chapter XIII

FINANCIAL MANAGEMENT SYSTEMS REVIEWS

I. Introduction.

This chapter provides guidance for conducting financial management systems reviews of any organization regardless of its type (e.g., profitmaking, other nonprofit, educational, hospital, and State, local, and Indian tribal governments).

Financial management systems reviews relate to the overall examination of the financial management policies, procedures, and controls maintained by an organization which affect the incurrence of costs. Generally, the incurrence and levels of costs are the result of management decisions in choosing between alternative methods of accomplishing the organization's objectives. Management decisions which affect the organization's levels and controls over costs relate to such matters as organizational structure, accounting systems, policies and procedures, budgeting, purchasing, personnel, internal controls, etc.

Although reviews of financial management systems should be a consideration of all initial awards and renewals, such reviews are of particular importance where:

- A. The applicant is a new organization or one that is being established for the purpose of performing work under PHS projects.
- B. An established organization is commencing work under PHS projects.
- C. The organization is known to be experiencing operational and/or financial difficulties as a supplier or subcontractor for private customers on either Government or commercial work.
- D. The award will significantly change the level or nature of the organization's operations.
- E. In the opinion of PHS, there are known facts or circumstances which support reasonable doubts as to the adequacy of the organization's financial management capability.

Where the reviewer determines, in accordance with PHS policies or the circumstances involving a particular case, that there is a need for an indepth financial management systems review, a request for such services should be submitted promptly to the HHS Office of Audit (HHS/OA). In the case of a centralized program project, the request for audit support should be submitted through the agency's audit liaison official to the Audit Coordination Division, HHS/OA. If the request originates in the region itself, it should be sent directly to the HHS/OA Regional Audit Office.

In situations where the HHS/OA is unable to provide the desired services, a request for assistance may be submitted to either of the following:

- A. PHS Cost Advisory Staffs, provided that such offices have the resources and agree to perform such reviews.
- B. Any of the organizations with which PHS has working agreements for the performance of such services (e.g., independent public accounting firms).

It is suggested that requests for such reviews be made promptly, to allow for a timely performance of the examination. Upon completion of the examination, the reviewing activity will issue a report containing an opinion on the acceptability of the organization's financial management system. Where the reviewing activity recommends the rejection of an applicant because of an independent financial management system, the report will set forth the reasons for such an opinion. Where the decision is to make the award notwithstanding the recommendation(s) of the report, care should be exercised to ensure that remedial action to eliminate the deficiencies within the system is being or has been taken by the organization.

If there is insufficient data available to determine the acceptability of the applicant's financial management system, the reviewer may conclude that a site visit is necessary. Additionally, where it is not practical to request assistance or perform a site visit, the reviewer may find it necessary to conduct an examination of the prospective awardee's financial management system without any assistance.

A sample questionnaire which may be used for evaluation of financial management systems is presented at the end of this chapter.

II. Objective of a Financial Management Systems Review

The objective of a financial management systems review is to provide those responsible for awarding and administering Government projects with information and advice concerning the adequacy of grantees' or contractors' financial management practices affecting the incurrence and control of costs.

III. Areas of Particular Concern

The following is a list of problem areas which may be encountered while reviewing the adequacy of a financial management system. The existence of any of these deficiencies does not necessarily mean that an award cannot be processed. It does indicate, however, that corrective or remedial action on the part of the organization is necessary to assure adequate accountability and control of costs incurred under a Government project.

- A. Absence of an Operational Accounting System—This situation may occur with new organizations which are commencing business. It is extremely important that all organizations doing work for PHS have an operational accounting system. Otherwise, the task of administering and accounting for costs and funds under the Government project(s) cannot be relied upon, to the probable detriment of the program(s). An operational accounting system is a standard method of collecting, recording, and reporting data as it relates to the control of assets, liabilities, revenues and expenses, and the results of transactions within an organization.
- B. Absence of a Project Cost Accounting System—Generally, this occurs within established organizations which are commencing business with Government agencies. Organizations which deal with commercial entities find it sufficient to conduct business by utilizing a general cost accounting system. This occurs because there is no need to report on costs in-

curred to their clients/customers, since their chief concern is to deliver the product or service sold at a stipulated price. However, under Government cost-type contracts or grants, the Government reimburses the contractor or grantee for the costs actually incurred – up to a specific amount – for delivering the services or products agreed to. A project cost accounting system is the standard method of collecting, recording, and reporting costs incurred by individual projects.

- C. Absence of Written Accounting Policies and Procedures – Under these circumstances, a lack of uniformity in accounting practices exists. This situation results in inconsistent treatment of similar costs incurred for like purposes under different projects. Consequently, certain projects are unfairly burdened with costs attributable to other projects.
- D. Absence of Personnel Policies and Procedures – This deficiency may lead to unfair compensation practices which may result in inequities and inconsistencies in accounting for personnel costs (e.g., fringe benefits which are paid only to employees working on Federal projects).
- E. Absence of Time and Effort Reporting Requirements – Where time and effort reporting requirements are not observed, there is considerable doubt as to the accuracy of recorded and claimed labor costs.
- F. Lack of Written Policies or Procedures Concerning the Use and Reimbursement of Consultants – Substantial use of consultants, together with inadequate determinations of need or selection processes, may be an uneconomical course of action which increases project costs without adding appreciably to the attainment of the program objectives.
- G. Lack of Written Policies Concerning Travel Expenditures – This deficiency may result in excessive use of travel time and effort. In addition, absence of maximum limits on expenditures while on travel status could result in abuses of the practices.
- H. Absence of Adequate Control and Accountability for Equipment – When no such policy exists, it is doubtful that adequate protection can be provided to Government-furnished equipment and/or equipment acquired by the grantee/contractor with Government projects' funds.

IV. Detailed Procedures

The following procedures are intended to provide guidance in conducting a survey of an organization's financial management system. The procedures include principal activities for conducting site visits, as well as other activities for evaluating specific areas of concern.

<i>Steps</i>	<i>Comments</i>
1. Planning for a site visit.	1. This may include the following actions: <ul style="list-style-type: none"> a. Reviewing the applicant organization's files to determine whether any reviews were performed previously and examining all file material. b. Discussing with appropriate program staff and other PHS officials, areas of concern regarding the organization's proposed budget. c. Inviting appropriate program staff to participate in the site visit review.

- 2. Site visit protocol.
- 3. Obtain basic information concerning the organization under review.
 - a. Type of organization applying for the award.
 - b. Names and titles of principal officers, partners, employees, etc., responsible for the business affairs of the organization.
 - c. Type of operation in which the organization is involved.
 - d. Annual revenues volume and extent of Government participation in the total revenue pool.
- d. Calling the organization as far in advance as possible to set a date for the site visit (usually the business manager or project administrator).
- e. Obtaining the names and duties of individuals who will participate in the site visit review.
- f. Sending a follow up letter of confirmation to the grantee/contractor within 3 days of the call.
- 2. In addition to the guidance specified in this chapter, the cost analyst/management specialist should use the detailed procedures presented in Chapter XIV of this Manual.
 - a. The cost analyst should determine whether the applicant is a profitmaking, other nonprofit, hospital, educational, or State, local, or Indian tribal government.

The necessity of identifying the type of organization applying for the award is important because the cost principles and administrative requirements are not the same for all organizations.
 - b. All contracts regarding financial management aspects of the organization and/or the proposed award, should be with the appropriate business officials.
 - c. This may include such fields as manufacturing, services, construction, research, etc. For an established organization, an accounting system is usually designed to fit its particular needs. Usually, construction and research organizations will have operational job order cost accounting systems. Manufacturing and services organizations, unless already involved in Government work, will usually operate without a project cost accounting system.
 - d. The greater the participation of the Federal Government in the revenue pool, the more the likelihood that other Government agencies may have reviewed and approved their accounting or financial management systems.

- e. Government agencies for which the organization is doing work or has recently done work.
 - f. Cognizant Government audit agency.
 - g. Name of outside auditors.
 - h. Accounting period in use.
 - i. Are employees in a position of trust covered by fidelity bonds?
4. Review the applicant's accounting system.
- a. Inventory the general and subsidiary books of account maintained by the organization.
 - e. If the organization has been conducting business with other Government agencies, the extent of review may be limited to obtaining opinions of the adequacy of the system for such agencies.
 - f. The cognizant Government audit activity would be an appropriate source for an opinion of the adequacy of the accounting and financial management systems, provided that the auditors have performed a relatively recent review.
 - g. Obtain the name and address of outside auditors for future reference should there be a need to contact them. Obtain other financial information, such as type of services provided, audit of financial statements, tax services, etc.
 - h. Is the organization on a calendar or a fiscal year basis? When does the accounting year end?
 - i. Individuals who are in a position of trust and employees handling cash should be bonded. This procedure affords financial protection from any possible misuse of Government funds.
 - a. Usually, an organization doing business under Government projects should have the following books of account and journals:
 - 1) General ledger—This ledger contains all financial data accounts, classified in detail, summarizing all the transactions affecting assets, liabilities, and equity of an organization.
 - 2) Operating ledger—This ledger contains all revenue and expense accounts classified in detail, summarizing all the transactions relating to operating revenues and expenses of an organization.
 - 3) Project cost ledger—This is a subsidiary ledger containing data by cost element (e.g., labor, materials, equipment, travel) for each project.

NOTE: Organizations which are or will perform under a single Government grant or contract need not have a project cost ledger in its accounting system since all costs incurred are attributed to one project. However,

organizations performing under more than one project must have a project cost ledger to segregate and accumulate costs by project.

- 4) Cash receipts journal—This is a journal in which all cash receipts of an organization are entered chronologically, indicating the source of funds received.
 - 5) Cash disbursements journal—This is a journal in which disbursements of an organization are chronologically entered, indicating the purpose for each disposition of funds.
 - 6) Payroll journal—This journal records and distributes employees' time charges to the appropriate projects and/or functions; records employee benefits such as vacation time, sick leave, and other time off. This journal also records required salary deductions (e.g., Federal and State income taxes and other deductions as authorized by the employees).
 - 7) Income (Sales) journal—This journal records all income, individually or in groups, received by an organization.
 - 8) Purchases journal—This journal records all purchases on credit for goods and services of an organization.
 - 9) General journal—This is the journal in which transactions not provided for in other specialized journals are recorded.
- b. Determine whether the books of account maintained are adequate for and suited for the organization's business.
- c. Determine whether the accounting system in use is adequate for the accumulation and segregation of costs on a project-by-project basis.

A project cost accounting system accumulates and segregates costs by projects. This method of cost accounting provides cumulative information relating to costs incurred by individual projects, thereby facilitating an efficient management and control of project funds.

- d. Determine whether cost records are controlled by or periodically reconciled with the general books of account.
 - e. Determine whether the accounting system provides for a reliable determination of costs.
 - f. Determine whether the prospective awardee has an accountant to handle financial and business data.
 - g. Determine whether the prospective awardee has engaged outside auditors for a review of financial statements and to provide counsel on financial management matters.
5. Survey the applicant's purchasing procedures.
- a. Determine whether the organization has written purchasing procedures.
 - b. Evaluate the adequacy of the procurement practices and procedures.
 - a. Obtain a copy of the organization's written policies and procedures for your review. Where there are no written policies and procedures, obtain a description of the practices in use and request that the organization develop them.
 - b. Desirable features of adequate procurement policies include:
 - 1) Centralization of purchasing activities to prevent excessive or wasteful purchasing.
- d. Costs recorded in the job cost ledger should tie in with those recorded in the operating ledger and other accounting records.
 - e. All costs attributed to a project should be supported by adequate documentation such as invoices, time or effort reports, etc.
 - f. All organizations performing work under Government projects should have an individual(s) on their staff with the necessary educational and experience background in accounting to handle the Government project(s). Where there is no such individual(s), it is imperative that the organization be made aware of the importance of possessing such expertise, to properly provide for adequate financial management of government projects.
 - g. It is good business policy for an organization to have outside auditors to review and evaluate management business practices and the results of operations on a periodic basis. Additionally, outside auditors possess the professional expertise to provide business management services such as (a) installation and improvements of accounting systems, (b) strengthening of internal controls, (c) preparation and filing of tax returns, (d) bookkeeping services, (e) auditing services, etc. Review of outside auditors' statements—as indicated elsewhere in this Manual—by the cost evaluator is an important method of determining the adequacy of a prospective awardee's financial management system.

6. Survey the applicant's personnel records and procedures.
 - a. Determine whether the organization has written personnel procedures.
 - b. Evaluate the adequacy of the personnel practices and procedures.

- 2) All purchasing should be supported by purchase orders which should be reviewed and approved by the responsible purchasing official.
- 3) All purchase orders should be supported by properly prepared and authorized purchase requisitions. All purchase requisitions should cite the purchase justification, item/service description, quantity desired, and the estimated cost.
- 4) Competitive bidding procedures should be utilized whenever purchasing items/services are of significant cost.
- 5) Where appropriate, analyses of lease and purchase alternatives should be made to determine the most economical cost.

- a. See comment 5.a. above.
- b. Desirable features of adequate personnel records and procedures include:
 - 1) Hiring, dismissal, or change in pay should be authorized by the personnel director or another authorized official of the organization.
 - 2) There should be an established wage and salary schedule covering all employees.
 - 3) There should be a description of duties and responsibilities for all employees.
 - 4) There should be an individual personnel file for each employee in the organization. At a minimum, the following data should be contained in the file.
 - Résumé
 - Position description
 - Hiring information
 - Appropriate tax forms
 - Insurance forms
 - Copies of any personnel actions
 - Copies of personnel evaluations and/or appraisals

c. Determine whether the organization has established adequate payroll distribution and/or time or effort reporting requirements.

c. Briefly summarized, the standards for documentation of payrolls are as follows:

1) State, local, and federally recognized documentation of payrolls are as follows:

- a) Time and attendance or equivalent records for individual employees.
- b) Time distribution records for employees whose compensation is chargeable to more than one project or cost objective.

2) Educational institutions:

- a) A system of plan-confirmation.
- b) A system of after-the-fact activity records.
- c) A system of multiple confirmation records.

3) Other nonprofit organizations including hospitals:

a) Monthly after-the-fact activity reports including a signed certification by the employee or a responsible supervisory official having firsthand knowledge of the work performed that the distribution of activity represents a reasonable estimate of the actual work performed by the employee during the periods covered by the reports. Each report must account for the total activity for which the employee is compensated and which is required in fulfillment of his/her obligations to the organization.

b) For nonprofessional employees, additional supporting records indicating the total number of hours worked each day must be maintained in conformance with the Department of Labor's regulations implementing the Fair Labor Standards Act (29 CFR Part 516).

The distribution of salaries and wages must be supported by personnel activity reports as described above, except when a substitute system has been approved in writing by the cognizant agency designated under OMB Circular A-122.

4) For profitmaking organizations:

a) Time and attendance or equivalent records for all employees.

- b) Time distribution records for employees whose compensation is chargeable to more than one project or cost objective.

- 7. Survey the applicant's travel policies and procedures.
 - a. Determine whether the organization has established travel policies and procedures.
 - b. Evaluate the adequacy of the organization's formalized travel policies and procedures.
 - a. See comment 3.a. above.
 - b. An organization's travel policies and procedures should include the following features at a minimum:
 - 1) All travel should be approved by a supervisor prior to its occurrence.
 - 2) Travel advances should not be charged to projects.
 - 3) Trip reports must be prepared and approved shortly after completion of travel.
 - 4) Reimbursement claims based on actual costs incurred should be adequately supported by statements, receipts, invoices, etc.
 - 5) All travel vouchers should be reviewed and approved by a supervisor before payment.

- NOTE: In cases where the organization does not have formalized travel policies, the HHS Standardized Travel Regulations will apply.

- 8. Survey the applicant's policies and procedures for the use of consultants.
 - a. Determine whether the organization has written policies and procedures.
 - b. Evaluate the adequacy of the organization's policies and procedures or practices in use.
 - 8. Criteria for use of consultants are discussed in Chapter IX of this Manual.
 - a. See comment 5.a. above.
 - b. Desirable features of adequate policies include:
 - 1) Evaluation of in-house capability supporting determination of need for services.
 - 2) Utilization of a selection process to secure the most qualified individual(s).
 - 3) Approval of selection of consultants by a senior official of the organization.
 - 4) Assurance that consultants' fees are appropriate considering their normal charges and nature of services to be provided.

9. Survey the applicant's property management policies and procedures.
 - a. Determine whether the organization has written policies and procedures relating to property management.
 - b. Evaluate the adequacy of the organization's property management policies and procedures or practices in use.
 - a. See comment 5.a. above.
 - b. The organization's property management standards should include the following procedural requirements:
 - 1) Property records outlining description, cost, acquisition date, source of property, location, use and condition, percentage of Federal participation in the ownership, and ultimate disposition data.
 - 2) A physical inventory of the property should be taken at least once every 2 years.
 - 3) Property owned by the Government should be adequately marked to indicate ownership.
 - 4) A control system to ensure adequate safeguards to prevent loss, damage, or theft of the property should be in effect.
 - 5) Maintenance programs to keep the property in good use and working condition should be in effect.
10. Survey the applicant's indirect costs practices.
 - a. Determine whether the organization's indirect costs are recorded separately.
 - b. Determine whether costs unallowable under applicable Government cost principles are segregated on the books of account from costs to be apportioned to Government projects.
 - a. Indirect costs should not be commingled in the books of account with those costs which are readily identifiable with a project. (See Chapter X, "Review of Indirect Costs.")
 - b. The organization should have knowledge of those costs which are expressly unallowable in accordance with the applicable laws and regulations. For example, entertainment, donations, and interest expenses are unallowable under Government projects. Accordingly, the organization should exclude such items in recording and claiming costs under Government projects. Such unallowable costs should be accounted for separately.
11. Survey the organization's system of internal controls.
 11. A system of internal controls includes all coordinated methods and measures adopted by an organization to safeguard its resources, assures the accuracy and

reliability of its accounting and cost data to promote operational efficiency, and encourages adherence to established management policies and procedures.

A system of internal controls constitutes the methods followed by an organization to:

- Protect assets.
 - Protect against the incurrence of improper liabilities.
 - Assure the accuracy and reliability of all financial and operating information.
 - Judge operating efficiency.
 - Measure adherence to established policies and procedures.
- a. Determine whether the organization has an organizational structure which provides appropriate segregation of functional responsibilities.
- b. Determine whether the organization has a system of authorization and record procedures adequate to provide reasonable accounting control over assets, liabilities, revenues, and expenses.
- a. An organizational structure provides for the proper assignment of authority and responsibility among departments, individual officers, and employees so as to furnish the necessary segregation of duties and responsibilities. Duties of the management staff must be allocated so that the responsibilities for operations, custodianship, and reporting are separate and distinct and can be immediately subjected to the challenge and scrutiny of the chief executive officer and board of directors.
- b. This phase of internal control is primarily concerned with detailed accounting and operational procedures. Another function of this phase of internal control is to safeguard assets.

The information produced by the system must be based on objective facts maintained in the form of records. Documentation supporting the accounting records should be kept in a central location. The accounting records should be the sole source of financial information in the organization and should be the responsibility of one individual.

Examples of internal control in this area are:

- Employees handling cash should be bonded. Bonding is a protection to the employer, and it serves as a psychological deterrent to the employee.
- Responsibilities for the handling of cash should involve at least two persons. This procedure lessens the

c. Determine that employees' qualifications are commensurate with their assigned responsibilities.

d. Determine whether the organization has adequate practices to be followed in the performance of duties and in the functions of each of the organizational departments, offices, and employees.

possibility of funds misappropriation by employees of the organization.

– Employees handling cash should be rotated on a job, if possible. Rotation reduces the opportunity for fraud.

– Vacations for employees in position of trust (e.g., cash handling) should be enforced.

c. The organization should have procedures which would ensure that employees are selected carefully and trained to properly discharge their assigned responsibilities.

For example, individuals in charge of accounting and financial operations should have the necessary educational and experience background to properly and effectively discharge their responsibilities. If this is not possible, these individuals should receive proper training. Adequate training would result in higher performance, reduced costs, and better experienced employees.

d. This phase of internal control promotes operational efficiency and encourages adherence to prescribed managerial policies. These purposes are achieved in part by establishing departmental personnel responsibilities. They are further accomplished by installing reporting procedures which measure the performance of each breakdown of responsibility, thereby exposing such measurements to review, cross-check, or criticism.

Examples of internal control in this area are:

– Operating instructions for each position should be in writing. These manuals of procedure promote efficiency and prevent misunderstanding.

– Lines of responsibility should be clearly established. This feature allows management to periodically check on progress made or performance based on established goals.

12. Summarize results of survey review.

a. Exit conference.

a. Site visits should be concluded with an exit or summation conference with the program director and fiscal officer present or other governing authority of the organization if possible. At the exit conference, a summary of the findings

b. Final report.

should be provided giving all present the opportunity to discuss these findings and to offer any further information that may have been overlooked. The findings should be reported as tentative since an official report must be prepared.

- b. A final report on the review should be prepared with a summary of the findings, recommendations, and suggestions regarding the financial and administrative management systems, allowability of costs, etc. If the review excluded any of these major categories, the reviewer's report should indicate the reason(s) for it with an explanation for each item excluded. If acceptance of the financial management system is conditional, a letter should be prepared and sent to the grantee/contractor detailing the findings and recommendations resulting from the review. This letter should request the grantee/contractor to respond within 30 days to any recommendations requiring corrective actions. A copy of the report and corrective actions taken by the grantee/contractor should be maintained in the official file.

PUBLIC HEALTH SERVICE

**QUESTIONNAIRE FOR EVALUATION
OF
FINANCIAL MANAGEMENT SYSTEMS
OF
GRANTEE AND CONTRACTOR ORGANIZATIONS**

U.S. Department of Health and Human Services

Revised September 1986

Blank Page

**Questionnaire for Evaluation of Financial Management Systems
of Grantee and Contractor Organizations**

Grantee/Contractor Name

Grant/Contract Name (If applicable)

Grantee/Contractor Representative

Date

Reviewer

QUESTIONNAIRE FOR EVALUATION OF FINANCIAL MANAGEMENT SYSTEMS OF GRANTEE AND CONTRACTOR ORGANIZATIONS

This questionnaire has been designed as an aid in reviewing the adequacy of financial management systems of PHS grantees and contractors. It is to be used by grants and contracts specialists. The questionnaire provides the framework from which the nonaccountant may evaluate and determine major weaknesses in grantee/contractor management practices, accounting systems, or internal controls.

Although the questionnaire may be used on all applicant organizations, it may be desirable to revise it when reviewing financial management systems of large and long-established organizations (e.g., universities, State and/or local Government agencies, et al). In such instances, the questionnaire may be expanded or modified to provide coverage as appropriate. However, the questionnaire must be used without exception when evaluating financial management systems of applicant organizations where one or more of the following conditions exist:

- A. Prospective awardee is a new organization to the Federal Government.
- B. Award will drastically change the level or nature of organization's operation.
- C. There are known management or accounting deficiencies.

The assessment of whether an organization is capable of discharging its financial management responsibilities is dependent on the preponderance of the answers to the questionnaire. If, for example, most of the answers are "yes" then the assessment is that the organization generally possesses an adequate financial management system to safeguard Federal funds. If most of the answers are "no" there is the possibility of serious management deficiencies. However, if organizations do not maintain the basic books of account or do not have the ability to identify expenditures by grant or contract, they are considered to have serious management deficiencies requiring immediate remedial action regardless of the other answers.

When completed, this questionnaire should become part of the organization's official grant or contract award file.

If minor deficiencies are noted, the evaluator should condition all awards pending remedial actions by the institution.

If major deficiencies are noted, technical assistance (e.g., HHS Office of Audit) should be requested. Awards should be delayed until a technical evaluation is completed and remedial action started.

The questionnaire does not purport to cover all aspects of a financial management system needed at a particular organization. The material is designed to provide basic coverage and the reviewer should select those questions most applicable to the system being evaluated. The items listed below provide a comprehensive coverage in the evaluation of financial management systems.

- A. General Information
- B. Accounting System
- C. Budgetary Controls
- D. Personnel
- E. Payroll
- F. Consultants
- G. Property Management
- H. Purchases
- I. Travel
- J. Internal Controls
- K. Program Income or Grant-Related Income
- L. Institutional Prior Approval System

Questionnaire for Evaluation of Financial Management Systems

	YES	NO	N/A	COMMENT/REFERENCE
<i>A. General Information</i>				
1. Does the organization have a Board of Directors with specific functions and responsibilities (By-laws)? (Obtain list of officers.)				
2. Are minutes of the Board of Directors' meetings maintained? (Review minutes for items related to financial management system issues.)				
3. Is there an organizational chart or similar document establishing clear lines of responsibility and authority? (Obtain a copy.)				
4. Are duties for key employees of organization defined? (Obtain a list of key personnel.)				
5. Does the organization have grants or cost reimbursable contracts with:				
a. Other PHS agencies?				
b. Other Federal agencies? (Obtain a list of all support, Federal, non-Federal, and percentages of support for each agency.)				
6. Has any aspect of the organization's activities been recently audited by a Government agency or independent public accountant? (If yes, obtain copy of audit report(s).)				
7. Has the organization obtained fidelity bond coverage for responsible officials and employees of the organization? (Indicate personnel covered and amounts of coverage.)				
8. Has the organization obtained fidelity bond coverage in amounts required by statute or organization policy?				

	YES	NO	N/A	COMMENT/REFERENCE
B. Accounting System				
1. Is there a chart of accounts?				
2. Is a double-entry accounting system used?				
3.* Does the organization maintain the basic books of account as applicable?				
a. General ledger				
b. Operating ledger				
c. Project cost ledger				
d. Cash receipts journal				
e. Cash disbursement journal				
f. Payroll journal				
g. Income (Sales) journal				
h. Purchase journal				
i. General journal				
(If not, describe the books of account maintained.)				
4.* Does the accounting system adequately identify receipt and disbursement for each grant or contract?				
5. Does the accounting system provide for the recording of expenditures for each program by required budget cost categories?				
6. Does the accounting system provide for recording the non-Federal share and in-kind contributions?				

	YES	NO	N/A	COMMENT/REFERENCE
7. Does the organization prepare financial statements at least annually? If not, how often? (Obtain a copy of latest statements.)				
8. Have the financial statements been audited within the last 2 years by an independent public accountant?				
9. Does the organization have a bookkeeper or an accountant? (If not, who is in charge of the accounting section or department?)				
10. Is there an accounting instruction manual?				
*A negative response requires immediate remedial action.				

	YES	NO	N/A	COMMENT/REFERENCE
<i>C. Budgetary Controls</i>				
1. Does the organization use an operating budget to control project funds?				
2. Are persons in the organization who approve budget amendments authorized to do so by the Board of Directors or top management?				
3. Are there budgetary controls in effect to preclude incurring obligations in excess of (e.g., comparison of budget with actual expenditures on a monthly basis):				
a. Total funds available for an award?				
b. Total funds available for a budget cost category?				
4. Are cash requirements and/or draw downs on letter of credit limited to immediate needs? (Check last bank statement(s) for unreasonably large cash balance(s).)				

D. *Personnel*

1. Are personnel policies established in writing or in the process of preparation which detail at a minimum:
 - a. Duties and responsibilities of each employee's position?
 - b. Qualifications for each position?
 - c. Salary ranges associated with each job?
 - d. Promotion plan?
 - e. Equal employment opportunities?
 - f. Annual performance appraisals?
 - g. Types and levels of fringe benefits paid to professionals, nonprofessionals, officers, or governing board members?

(Obtain a copy.)
2. Is employee compensation reasonable and comparable to that paid for similar work in the competitive labor market? (How does it compare? Is it reasonable?)
3. Are salary comparability surveys conducted? How often?
4. Are salaries of personnel assigned to Government projects about the same as before assignment? (Identify reasons for significant increases.)
5. Does the organization maintain a payroll distribution system which meets the required standards as contained in the applicable cost principles for that organization? (See section IV.6.c., chapter XIII of this chapter for a summary of the required payroll distribution standards.)

	YES	NO	N/A	COMMENT/REFERENCE
6. Does the organization maintain daily attendance records for hourly employees? (Is this a "positive" recording system showing actual time and attendance performed?)				
7. Does the payroll distribution system account for the total effort (100 percent) for which the employee is compensated by the organization?				
8. Who signs and certifies work performed in items 5, 6, and 7? (Obtain copies of documents and/or forms used on those items.)				
9. Where duties require employees to spend considerable time away from their offices, are reports prepared for their supervisors disclosing their outside activities?				

	YES	NO	N/A	COMMENT/REFERENCE
11. Is the payroll signed prior to payment by:				
a. The employee preparing the payroll?				
b. The employee rechecking the payroll?				
12. Are salary payrolls approved by an authorized official prior to payment?				
13. Are employees paid by check? (If not, how are they paid?)				
14. If paid by check, are the checks prenumbered?				
15. Are checks drawn and signed by employees who do not:				
a. Prepare the payroll?				
b. Have custody of cash funds?				
c. Maintain the accounting records?				
16. Are payroll checks distributed to employees by someone other than the supervisor?				
17. Is there a payroll bank account? (If not, request that a bank account be opened.)				
18. Is the payroll bank account reconciled by someone other than payroll staff or personnel who sign or distribute the pay checks?				

	YES	NO	N/A	COMMENT/REFERENCE
F. <i>Consultants</i>				
1. Are there written policies or consistently followed procedures regarding the use of consultants which detail at a minimum: <ul style="list-style-type: none"> a. Circumstances under which consultants may be used? b. Consideration of inhouse capabilities to accomplish services before contracting for them? c. Requirement for solicitation or bids from several contract sources to establish reasonableness of cost and quality of services to be provided? d. Consulting rates, per diem, etc? (Obtain a copy.)				
2. Are consultants required to sign "consulting agreements" outlining services to be rendered, duration of engagement, reporting requirements, and pay rates?				

YES NO N/A COMMENT/REFERENCE

G. *Property Management*

1. Are records maintained which provide a description of the items purchased, the acquisition cost, and the location?
2. Are detailed property and equipment records periodically balanced to the general ledger?
3. Are detailed property and equipment records periodically checked by physical inventory?
4. Are there written procedures governing the disposition of property and equipment? (Obtain written procedures. If not, briefly describe them.)
5. Are periodic reports prepared showing obsolete equipment, equipment needing repair, or equipment no longer useful to the organization?

H. *Purchases*

1. Does the organization have written purchasing procedures? If not, briefly describe how purchasing activities are handled. (Obtain a copy of policy or procedure.)
2. Does the policy/procedure consider such matters as quality, cost, delivery, competition, source selection, etc.?
3. Has the responsibility for purchasing been assigned to one department, section, or individual within the organization? (If not, explain.)
4. Is the purchasing function separate from accounting and receiving?
5. Are competitive bids obtained for items such as rentals or service agreements over specific amounts?
6. Are purchase orders required for purchasing all equipment and services?
7. Is control maintained over items or dollar amounts requiring the contracting or grants management officer's advance approval? (Describe controlling factors.)
8. Is the accounting department notified promptly of purchase goods returned to vendors?
9. Is there an adequate system for the recording and checking of partial deliveries and checked against the purchase order?
10. When only a partial order is received, is the project account credited for the undelivered portion of the purchase order?

YES	NO	N/A	COMMENT/REFERENCE

	YES	NO	N/A	COMMENT/REFERENCE
11. Are the vendor invoices checked for:				
a. Prices and credit terms?				
b. Extensions?				
c. Errors and omissions?				
d. Freight charges or disallowances?				
12. Are vouchers, supporting documents, expenses, or other distributions reviewed and initialed by designated staff before payment is authorized?				

I. *Travel*

1. Does the organization have formal travel policies or consistently followed procedures which, at a minimum, state that:
 - a. Travel charges are reimbursed based on actual costs incurred or by use of per diem and/or mileage rates?
 - b. Receipts for lodging and meals are required when reimbursement is based on actual cost incurred?
 - c. Per diem rates include reasonable dollar limitations? Subsistence and lodging rates are comparable to Federal per diem rates and current Federal mileage rates for personal auto use? (If not, obtain organization travel rates policy.)
 - d. Commercial transportation costs are incurred at coach fares unless first class is adequately justified?
 - e. Travel requests are approved prior to occurrence?
 - f. Travel expense reports show purpose of trip?

(Obtain a copy of policy or describe procedure.)

	YES	NO	N/A	COMMENT/REFERENCE
<i>J. Internal Controls</i>				
1. Is there a separation of responsibility in the receipt, payment, and recording of cash? For example:				
a. Are the duties of the recordkeeper or bookkeeper separated from any cash functions, e.g., receipt or payment of cash?				
b. Is the signing of checks limited to those designated officials whose duties exclude posting and/or recording cash received, approving vouchers for payment, and payroll preparation?				
2. Are all checks approved by an authorized official before they are signed?				
3. Are all accounting entries supported by appropriate documentation (e.g., purchase orders, vouchers, vendor payments)?				
4. Does the organization have an internal auditor or internal audit staff?				
5. Is there a petty cash fund where responsibility is vested in one individual; limited to a reasonable amount; restricted as to purchase; and counted, verified, and balanced by an independent employee at time of reimbursement?				
6. Are all checks prenumbered and accounted for when general purpose bank account is reconciled?				
7. If a mechanical or facsimile signature is used for cash disbursements, is the signature plate, die, key, electronic card, etc., under strict control?				

	YES	NO	N/A	COMMENT/REFERENCE
8. Are bank accounts reconciled by persons not handling cash in the organization?				
9. Are all employees who handle funds required to be bonded against loss by reason of fraud or dishonesty?				

	YES	NO	N/A	COMMENT/REFERENCE
K. <i>Program or Grant-Related Income</i>				
1. Is the organization aware of the applicable PHS program or grant-related income policy?				
2. Does the organization have written policies and procedures relating to program or grant-related income? (If yes, proceed below.)				
a. Does the applicant maintain records of the earning, receipt, and disposition of program or grant-related income for which it is accountable?				
b. Does the program or grant-related income accounts identify the type and source of income producing services?				
c. Is a management system in effect that adequately identifies program or grant-related income for each Government project?				
d. Is there a system to properly dispose of program or grant-related income?				
e. Are there any financial statements available issued by an independent accounting firm which identify the source and disposition of program or grant-related income?				

	YES	NO	N/A	COMMENT/REFERENCE
L. <i>Institutional Prior Approval System (IPAS)</i>				
1. Does the organization have an IPAS established?				
2. Who is authorized to request PHS funds? To whom does this person(s) report?				
3. Are there procedures describing the IPAS process?				
4. Are there internal controls which preclude a principal investigator from rebudgeting without prior approval?				
5. Are rebudgeting requests ever denied?				
6. Have there been any retroactive approvals?				
7. Are rebudgeting approvals established by indepth reviews by the responsible officials?				
8. Are approval actions in compliance with PHS policy?				

Chapter XIV

EVALUATION OF ADEQUACY OF FINANCIAL CAPABILITY

I. Introduction

The Office of Management and Budget (OMB) Circular A-129, "Managing Federal Credit Programs," requires grant and contract applicants, other than State and local governments and Indian tribal governments, to be screened in accordance with prescribed standards. This required screening is intended to assure that the status of the applicant's credit worthiness will not jeopardize the program objectives. Further, PHS deems it desirable to make an affirmative determination that the prospective awardee has adequate financial resources or the ability to obtain such resources as may be necessary to perform under the award. The determination by the PHS component of the applicant's financial capability will be based on a preaward qualification check or survey.

The need for financial information and analysis, and the scope, depth, and detail of analysis may vary reasonably with the circumstances of particular cases. In some instances, the extent of accumulation of financial data and its evaluation must be determined by the judgment of the reviewing personnel. In the case where there are prior relationships with organizations which are known to be financially strong, competently managed, and operating satisfactorily, the financial evaluation might well consist of no more than a scrutiny of readily available balance sheets and operating statements. In other cases, the financial analysis would have to be as broad and sufficiently detailed as necessary to fit the circumstances of the case.

PHS agencies, in awarding contracts and grants, shall give due regard to the financial capability of the applicants. Financial difficulties encountered by PHS awardees may (1) disrupt project schedules, (2) cause waste of resources, and (3) result in monetary losses to PHS if connected with advance payments, etc. To reduce these hazards, projects should be awarded to applicants who have the financial capability, technical skill, management competence, plant capability, and adequate facilities to perform under the terms of the grant or contract.

The evaluation of the financial capability of a prospective awardee is of particular importance where:

- The applicant is a new entity or one that is being established for the purpose of performing under PHS projects.
- The applicant has not had any ongoing awards with PHS within the preceding 12 months.
- The applicant is known to be experiencing financial difficulties as a supplier or subcontractor for private customers on either Government or commercial work. This information may become available from credit reports, through news media reports, dissemination of such data among Government procurement activities, etc.

- There are any known facts or circumstances which support reasonable doubts as to the applicant's financial capability or performance.

Where the cost evaluator determines, in accordance with PHS policies or the circumstances involving the particular case, that there is a need for a determination of the financial capability of the prospective awardee by financial analysts, cost advisory staffs, or auditors, a request for the performance of such reviews should be submitted promptly to any of the following:

- The cognizant HHS Office of Audit (HHS/OA).
- Other organizations with which PHS awarding offices have working agreements for the performance of such services (e.g., independent public accounting firms).
- The PHS Cost Advisory Staffs, provided that such offices have the resources and have agreed to perform such reviews.

II. Objective of the Review

The objectives of the review are to determine the extent and status of the applicant's financial dealings with the Government, and assure that the applicant has adequate financial resources, or the ability to obtain such resources (including Government financing) as are necessary to perform under the proposed project.

III. Areas of Particular Concern

The following is a list of problem areas which are of significant importance in determining the extent of review necessary to ascertain the financial capability of organizations. The existence of any of these conditions does not necessarily indicate that an organization is in a precarious financial condition. It does suggest, however, that a problem may exist and that an indepth financial capability review may be necessary.

These problem areas include:

- A. Failure of the prospective awardee to submit cost and financial data requested by the PHS evaluator for the review of the cost proposal.

Failure of the prospective awardee to provide the requested data; resistance, difficulties and delays in preparation; or poor quality of the data may well constitute warning signals that the applicant's planning has been insufficient and that significant financial difficulties may be encountered during the contemplated project period.

- B. Information from credit reports or other Government agencies, activities, etc., indicating doubts as to the financial capability of the applicant.

The PHS evaluator should attempt to identify and understand the reservations expressed by other Government activities. Moreover, the evaluator should ascertain whether the conditions which led to such doubts still persist, and/or whether any corrective measures have been instituted by the applicant, etc.

- C. Absence of sufficient funds to meet costs of operations and payment of liabilities in a timely manner.

This situation is demonstrated by a working capital ratio of less than one to one. (See Section V comment 3.c.1 for an explanation of the working capital ratio). Under these circumstances, the grantee/contractor is usually unable to perform adequately since there is a scarcity of funds to meet current obligations, much less to fund costs of operations (projects).

- D. Existence of substantial liabilities to the Internal Revenue Service for unpaid payroll taxes.

This information may be readily available by reviewing the notes accompanying the financial statements issued by the public accountant. This situation indicates that the applicant has had or continues to have a "lack of sufficient funds" problem.

IV. Detailed Procedures

In situations where (1) it is not practical to request financial capability reviews from such organizations as the HHS/OA, PHS Cost Advisory Staffs, or other activities within or outside the Federal Government, and (2) there is no sufficient data available from other sources, such as previous audit reports, information from procurement offices, etc., the cost evaluator may find it necessary to perform a limited review of the prospective awardee's financial capability without any outside assistance. Section V provides guidelines which will be of assistance in performing such limited financial capability reviews. The extent or the test or survey should be expanded or curtailed as considered appropriate under the circumstances.

V. Other Matters

Although not specifically required, under certain circumstances grants management personnel may deem it necessary to survey the financial capability of a grantee. (See GAM Part PHS: 700, "Exceptional Organizations.") In those cases, grants management personnel may use the steps outlined below in performing such surveys.

<i>Steps</i>	<i>Comments</i>
<ul style="list-style-type: none"> 1. Request from the prospective awardee appropriate data and information for a determination of its financial capability. 	<ul style="list-style-type: none"> 1. Data requested should consist of the following: <ul style="list-style-type: none"> a. Audited financial statements for the most recent accounting year. For the purpose of this review, "audited financial statements" are those statements issued by independent public accountants. For a definition of financial statements see Chapter XV, "Use of Audit Reports." b. Latest available interim financial statements prepared by the prospective awardee. c. Existing and contemplated credit or financing arrangements, such as: <ul style="list-style-type: none"> 1) Bank loan commitments.

2. Where available, request comments and opinions from the cognizant Government audit activity such as HHS/OA, Defense Contract Audit Agency, etc., concerning the applicant's accounting system, internal controls, and available audit findings on major elements of the financial statements.
 3. Evaluate financial data provided by the prospective awardee.
 - a. Verify the accuracy and reliability of the financial statements' representations.
2. Input from other Government activities, if adequate, may obviate the need for any analysis by the evaluator or may assist in the evaluation of financial capability of the applicant.
 3. As stated under 1. above, the organization under review should provide recent financial statements and comparable statements for prior periods. Where recent statements are not available, the prospective awardee should be requested to prepare them.
 - a. As explained in Chapter XV, financial statements reviewed by independent public accountants may be accompanied by any of four types of opinions on the reliability of the representations.

- 2) Loan commitments from officers, stockholders, etc., of the prospective awardee.
- 3) Projected equity capital increases in the case of profitmaking organizations.
- 4) Projected general fund increases for nonprofit organizations.
- 5) Government financing through grant/contract advances, progress payments, etc.

If an unqualified opinion of the financial statements has been provided by an independent accountant, this opinion as to the reliability of the financial representations should be accepted. It should be noted that although the financial statements may be accompanied by an unqualified opinion, this in itself is no assurance that the organization is in a sound financial condition or that it has an adequate accounting system for the accumulation of costs under Government projects. An unqualified opinion merely states that the financial statements' representations are fairly stated.

Where the financial statements are not accompanied by an unqualified opinion or where the statements have not been reviewed by an independent accountant,

- an evaluation as to the reliability of the representations may be requested from any of the following offices as appropriate:
- 1) Division of Cost Allocation/RASC.
 - 2) PHS Cost Advisory Staff.
 - 3) HHS Regional Inspector General for Audit.
- b. Other relevant data may include information concerning longstanding debts to the Internal Revenue Service for non-payment of payroll taxes, lateness in paying critical suppliers, landlords, pending litigations, etc. In the event that such creditors demand immediate payment, the applicant may be unable to continue operations.
- c. In appraising the organization's financial capability and ability to pay its obligations as they become due, use should be made of financial ratio tests.
- 1) The working capital ratio is one of the most reliable measures of the liquidity of an organization. Liquidity is the potential ability to meet obligations incurred in the normal performance of operations as they become due. Although acceptable working capital ratios differ from industry to industry, a working capital ratio of 2:1 is considered satisfactory. A working capital of less than 1:1 (such as 0.9:1) is precariously low as to imply insolvency for the entity being reviewed.

The working capital ratio may be computed from data appearing on the financial statement (balance sheet) by dividing the total current assets by the total current liabilities.
 - 2) The "quick assets" or "acid test" ratio serves as a supplementary check on the liquidity of an organization. This ratio is computed by dividing the current assets, exclusive of any inventory values, by the current liabilities. The ratio is indicative of the immediate liquidity of an organization and of its ability to pay immediate debts. Generally, a "quick assets" ratio of 1:1 is deemed adequate.
- b. Review all notes accompanying the financial statements to ascertain whether there are other data which may impact on the reliability of the statements, financial capability, etc.
- c. Analyze the financial ratios of the organization.
- 1) Test of working capital ratio.
 - 2) Test of "quick assets" or "acid test" ratio.

In the case of service organizations where inventory is not a significant factor, the "working capital" ratio and "quick assets" ratio will be the same.

4. Review other sources of financing available to the prospective awardee.
 - a. Bank loan commitments.
 - b. Loan commitments from officers, stockholders, etc., of the prospective awardee.
 - c. Proposed issues of stock.
 - d. Government financing through grant/contract advances, progress payments, etc.
4. Where the evaluator determines that the applicant does not have adequate financial capability to perform under the project, the evaluator should review data concerning other sources of financing. This examination becomes critical when the applicant appears to be in a precarious financial condition as evidenced by the tests performed by the evaluator.
 - a. This method of financing provides the prospective awardee with sufficient funds to finance operations through bank loans. The loans are then repaid with the proceeds from grants, contracts, etc. The commitments by the banks should be substantiated by letters of credit approving draws of funds to a certain amount, interest, etc.
 - b. This method of financing operations is similar to that provided through bank loan commitments, except that the funds are being provided by individuals instead of banks. These commitments of private individuals should be evidenced by formal written agreements to that effect.
 - c. This type of funding is usually available to profitmaking corporations only. Through issuances of capital stock shares, the corporation is able to generate and/or raise funds to finance operations, enlarge facilities, etc. As in the case of bank and private loan commitments, the prospective awardee should provide a prospectus and written statements from potential investors attesting to this type of funding.
 - d. Normally, PHS provides grant funds in advance to grantees to finance the work contemplated under the project(s). Under cost-type contractual agreements, costs are reimbursed as they are incurred, usually on a monthly basis.

Accordingly, in situations where a prospective awardee is in a "precarious" financial condition, the availability of Government funding could constitute

sufficient evidence that the prospective awardee will be financially capable of performing under the project.

5. Evaluate the credit rating of the prospective awardee.
5. A quick way to determine the financial condition and the extent of a prospective awardee's relationship with the Federal Government is by obtaining from Dun & Bradstreet Credit Services the "Government Activity Report," and the "Business Information Report." These reports would provide the cost evaluator with the following data.
 - a. Loan repayment conditions.
 - b. Contract fulfillment status.
 - c. Debarment information.
 - d. Grant/contractor performance.
 - e. Other business risks.
 - f. Suppliers' trade experiences on a firm's bill payments.
 - g. Balance sheet information for determining financial condition and trend.
 - h. Suits, liens, judgments against the prospective awardee..
 - i. Debt collection activity.
 - j. Procurement information on contracts, subcontracts, etc.Procurement offices can obtain credit reporting services through the GSA supply schedules.
6. Summarize the results of the review performed.
6. Where the results of the review do not disclose any exceptions indicating that the prospective awardee lacks the financial capability to perform, the evaluator should recommend funding of the project, subject to the results of a financial management systems review, cost analysis, program review, etc.

Where the results of the review indicate that the prospective awardee lacks the financial capability to perform, the evaluator should do either of the following:

- a. Recommend disapproval of the cost proposal because of the lack of adequate financial capability of the applicant.

Where an adverse recommendation is issued by the evaluator, the applicant should be informed of all details surrounding the case and afforded every opportunity to present and provide any ad-

ditional data which may affect the outcome of the review.

- b. Where the particular circumstances of the case so dictate it, request from HHS/OA, the appropriate cost advisory staff, etc., a special review of the applicant's records to determine whether, in fact, the applicant possesses the necessary financial capability to perform under the project.

Chapter XV

USE OF AUDIT REPORTS

I. Introduction

Over the last several years, an increasingly large number of audit reports issued by the Office of the Inspector General (OIG) of PHS grantees/contractors have been prepared by non-Federal auditors and fewer by OIG. Most of these non-Federal audits have been performed by CPAs. The increase in non-Federal audits has been caused by (1) Office of Management and Budget (OMB) Circular A-110 which requires that educational institutions, hospitals, and other nonprofit institutions receiving Federal grant funds be audited by an independent auditor, (2) OMB Circular A-102, Attachment P, "Audit Requirements," superseded by OMB Circular A-128 which establishes audit requirements for State and local governments that receive Federal aid, and (3) OIG's redirection of its audit resources away from grant and contract programs and towards other HHS programs and activities.

The purpose of this chapter is to provide information and procedural guidance for the efficient utilization of audit findings and recommendations.

Conclusions and recommendations of auditors (Government and non-Government) should be used to the maximum extent in arriving at opinions on the reliability of a prospective awardee's cost data, financial management systems, and other pertinent business practices.

II. Audit Requirements

Requirements concerning recipients of Federal financial assistance are contained in OMB Circular A-128, "Requirements for State and Local Governments," and OMB Circular A-110, Attachment F, "Uniform Requirements for Grants to Universities, Hospitals, and Other Non-profit Organizations – Standards for Financial Management Systems." These circulars require that each recipient be audited by independent non-Federal auditors annually or at least once every 2 years. Further, Circular A-128 requires that these audits be performed on an organization-wide basis, whereas Circular A-110 suggests that the audits be performed on that basis. The purpose of these audits is to determine whether (1) the financial statements of an audited entity present fairly the financial position and the results of financial operations in accordance with generally accepted accounting principles, and (2) the entity has complied with laws and regulations that may have a material effect upon the financial statements.

The audit requirements prescribed by the circulars differ significantly in the degree of testing to be performed and data to be provided in the reports. In this regard:

–Circular A-128 and Attachment P, "Audit Requirements" of Circular A-102 (now superseded), require that non-Federal audits be performed in accordance with the Comptroller General's "Standards for Audit of Governmental Organizations, Programs, Activities and Functions," and the "Guidelines for Financial and Compliance Audits of Federally Assisted Programs." Additionally, Circular A-128 contains specific provisions regarding the data to

be included in the report (e.g., statements reviewed, tests performed, adequacy of the systems).

- Circular A-110 sets forth the audit objectives to be achieved. However, the Circular neither requires the use of the Comptroller General's audit standards in the performance of audits of Federal awards, nor does it prescribe the use of any audit guidelines. Further, Circular A-110 does not prescribe the type and extent of information which the auditors must provide in the audit reports.

III. Types of Audit Reports

The following is a listing of audit reports which may be of assistance to cost evaluators.

- A. Audits of Costs Incurred—These reports provide an opinion concerning the acceptability of costs incurred and claimed by an organization under a specific Government project(s). Such reports may also provide data concerning the adequacy of financial or business practices of the organization.
- B. Indirect Cost Rate Audits—These reports provide an opinion and recommendations concerning determinations of indirect cost rates for specific accounting periods of an organization. In addition, the reports may also include conclusions and recommendations relating to the adequacy of the management policies and practices governing the accountability of indirect costs, equipment control, personnel policies and related costs, cost participation and matching, etc.
- C. Organization-Wide Audits—These reports provide an opinion and recommendations concerning internal controls and compliance reviews performed by an organization's independent auditor. The reports include conclusions and other data relating to the financial statements and schedule of Federal assistance, study and evaluation of internal control systems, and compliance with applicable laws and regulations.
- D. Pre-Award Surveys—These surveys are usually performed at the specific request of a contracts/grants officer prior to the award of a contemplated project. Normally, there are two categories of information which the report may furnish. One deals with the financial responsibility of the prospective awardee to perform under the project. The other category deals with the adequacy of the accounting system to accumulate the type of cost information required by the project.
- E. Initial Pricing Reviews—These reviews are performed to evaluate the purpose of evaluating the reasonableness of the cost elements supporting proposals submitted by prospective awardees in connection with the award, administration, modification, repricing, or recosting of Government projects.
- F. Quick Assessment Reviews—These examinations are designed to provide a quick assessment of the capability of prospective grantees/contractors to satisfactorily manage and account for HHS funds. The purpose of the review is to identify potential problems and to recommend corrective action(s) as appropriate.
- G. Functional Reviews—These detailed examinations of operations of grantees/contractors are performed to evaluate the effectiveness of management policies and procedures which affect the incurrence of costs.

- H. Contract Closing Audit Statements—These reports provide an opinion as to the acceptability of costs claimed on specific contracts.
- I. Reports on Financial Statements—These reports which are issued by independent public accountants engaged by an organization, express an opinion on the fairness of the financial statements, which are the representations of management.

All financial statements of an organization issued by a public accounting firm express an opinion as to the fairness of the representations of management for the period reviewed. The following is a description of the four types of opinions which may accompany the financial statements:

- 1. Unqualified opinion—The auditor expresses no reservations concerning the fairness of the financial statements' representations.

Additionally, an unqualified opinion provides a degree of assurance concerning the reliability of the system of internal controls and the adequacy of the accounting system of the organization.

- 2. Qualified opinion—Such an opinion is usually provided whenever (a) the auditee's application of accounting principles is improper, (b) the auditor has been restricted in the scope of his/her review, or (c) there is an uncertainty of position concerning the validity of certain assertions of the auditee.
- 3. Adverse opinion—An opinion of the reliability and fairness of the financial statements is denied by the auditor whenever (a) the scope of review is curtailed by management to such an extent that no meaningful review may be performed, (b) the auditor's exceptions or qualifications detected during the review are of sufficient magnitude to negate an opinion on the fairness of the representations of the financial statements.
- 4. Disclaimer of opinion—An auditor will disclaim an opinion as to the fairness of the financial statements whenever no review of the reliability of the representations of the report has been performed. In this situation, the accountant merely reports that the data appearing in the financial statement accurately reflect those which appear on the accounting records.

Financial statements issued by the public accountant usually include the following:

- 1. Balance sheet—A statement of financial position of an organization disclosing the assets, liabilities, and ownership at a given point of time.
- 2. Income or loss statement—A summary of the revenue and expenses of an organization for a specified period of time, usually for an accounting year.
- 3. Statement of application of funds—A report which summarizes the movements of funds (working capital) within an organization during a designated period of time.
- 4. Statement on Internal Accounting Controls—A report on methods and measures adopted within an organization to safeguard its assets, check the accuracy and reliability of its accounting data, promote operational efficiency, and encourage adherence to prescribed managerial policies.

IV. Sources of Audit Reports

- A. HHS Office of Audit – HHS/OA, as a function of their activities, performs limited reviews of organizations doing work under PHS projects. Generally, HHS/OA reports are confined to the reviews of (a) indirect cost rates, (b) costs incurred under HHS projects, (c) management policies and procedures relating to cost effectiveness, financial management administration, etc., and (d) quick assessment reviews. Reports on organization-wide audits, preaward surveys, and initial pricing evaluations, may also be provided by HHS/OA on special request. These types of reviews are also performed by other auditing activities (Government or non-Government) and issued by HHS/OA.

Copies of audit reports and other relevant data which may be helpful to the cost evaluator may be requested from the Audit Coordination Division, HHS/OA.

- B. PHS Cost Advisory Staffs – Each PHS operating agency has a cost advisory staff. These groups provide cost analysis services for centralized programs of their respective agencies. Based on the availability of resources, cost advisory staffs may be able to provide cost analysis services for regional programs.

It is suggested that upon identification of financially-related problem areas, the evaluator contact personnel of the respective cost advisory staffs for counsel. In addition, it is possible that the cost advisory staff(s) may have conducted recent reviews of the applicant's cost data and/or management capabilities; such information may be of considerable assistance to the evaluator. Copies of pertinent cost analysis reports may be requested from the issuing cost advisory office.

- C. Defense Contract Audit Agency – The Defense Contract Audit Agency (DCAA) performs all types of auditing services for the Department of Defense. Copies of pertinent audit reports may be requested from the issuing branch or resident office of DCAA.

DCAA may also provide limited auditing services for other interested Government agencies such as HHS. All requests for DCAA audit services must be submitted to Audit Coordination Division, HHS/OA. Requests originating in the region should be sent directly to the HHS/OA Regional Audit Office.

- D. Other Federal Government Audit Agencies – Other Federal agencies also have their own auditing activities to assist them in the administration of their contracts and grants processes. As in the case with DCAA, these auditing activities may also provide limited auditing services to other Government agencies, such as PHS, on special request. Among other notable Federal auditing agencies are: the National Aeronautics Services Administration Audit Agency, the Environmental Protection Agency Office of Audit, and the Department of Transportation Audit Agency. Where the evaluator determines that any other Federal Government audit agency has issued reports which may be of assistance in the performance of their function, copies of the audit reports may be requested directly from the issuing audit agency or from the Audit Coordination Division, HHS/OA.
- E. General Accounting Office – General Accounting Office (GAO) audits may pertain to financial management reviews of Government grantees/contractors. Copies of such audit reports may be obtained from the issuing regional GAO or from the Audit Coordination Division, HHS/OA.

- F. Public Accounting Firms—As previously stated, public accounting firms issue audit reports which express an opinion on the fairness of the financial statements of an organization. Additionally, public accounting firms may also prepare reports of management services provided or functional reviews performed for an organization.

Such reports, to the extent that they may be of assistance to the evaluator, may be obtained from the prospective PHS awardee or from the public accounting firm (with the approval of the awardee).

- G. State and Local Government Audit Agencies—Copies of audit reports issued by State Government audit activities may be requested directly from the issuing agencies. Among the types of reports issued by these agencies, which may be of assistance to the evaluator, are financial management systems and reviews of State agencies applying for Federal Government projects, indirect cost rate determinations, audits of costs incurred, etc.

V. Detailed Procedures

The following procedures are intended to provide guidance in the use of audit reports.

A. *Audit Reports Issued by Federal, State, and Local Government Audit Agencies*

<i>Steps</i>	<i>Comments</i>
1. Review the files maintained on the prospective awardee to ascertain whether any previous audit reports relevant to the ongoing review are available.	1. Review of previous audit reports would disclose to the evaluator any significant exceptions uncovered during examinations which may necessitate corrective action prior to the award of any subsequent projects.
2. Check with the prospective awardee to determine whether any other Government agency has conducted an audit of their costs, operations, financial management systems, etc.	2. Audit reports or reviews performed by other Government activities may be of assistance in arriving at an opinion concerning the adequacy of the organization's financial management systems.
3. Where no copies of reports of recent reviews are on file, contact the Government audit agency which has performed a review of the organization's activities.	3. Ascertain from the audit agency which conducted the review whether any negative findings were uncovered by the examination and if corrective actions have been taken. If no exceptions were found, a memorandum to the file to such effect is sufficient.
4. Request a copy of the audit report resulting from the review of the organization's activities.	4. Obtain copies of the audit reports issued by other Government agencies where such reports disclose management deficiencies.
5. Review the audit report(s) to ascertain whether the deficiencies in the organization's management policies affecting the incurrence of costs are of sufficient significance to warrant additional review or remedial action.	5. Significant deficiencies which would warrant a detailed review and/or remedial action before a project is awarded may include, but not be limited to, any of the following: <ol style="list-style-type: none"> a. Absence of an acceptable cost accounting system.

- b. Inadequate internal controls concerning the accountability of funds.
 - c. Inadequate purchasing policies and procedures (e.g., lack of competition for large purchases, poor controls over the receipts and disposition of goods and completed services procured).
 - d. Absence of time and effort reporting requirements which preclude adequate accountability of labor costs being charged to Government projects.
6. Where the audit report(s) cites deficiencies regarding management policies, the cost evaluator should contact the cognizant audit agency and/or the prospective awardee to ascertain what remedial action, if any, has been taken. The cognizant agency is the Federal activity which is charged with the oversight responsibility of resolving all issues raised by the audit report(s).
 7. Where no remedial action has been taken and the deficiencies are significant, the cost evaluator may recommend that the award be withheld until such deficiencies have been eliminated.
6. Where corrective action has been taken, the evaluator should attempt to determine whether the measures adopted by the prospective awardee are adequate to support the approval of the cost proposal under consideration. In determining whether the actions taken by the prospective awardee are adequate, the evaluator should seek the counsel and guidance of any of the following:
 - a. The audit agency which performed the review.
 - b. The HHS Regional Inspector General for Audit.
 - c. The PHS Cost Advisory Staffs.
 - d. The Cost and Audit Management Branch, DGC/ORM/OM/PHS.
 7. In the absence of any attempts by the prospective grantee to correct significant audit deficiencies, the evaluator should recommend that no award be made until such time as the corrective action is implemented.

Notwithstanding the recommendations of the cost evaluator to reject the award application because of significant unresolved audit exceptions, if a determination is made by higher level PHS officials that such award application be approved, the evaluator should recommend that funding of the project be authorized contingent upon the ability of the organization to effect and implement the audit recommendations.

B. *Audit Reports Issued by Independent Public Accounting Firms*

<i>Steps</i>	<i>Comments</i>
1. Request copies of the latest financial statements prepared by the prospective awardee's outside accountant(s).	1. Audit reports requested should be those for a complete accounting year. Such reports are accompanied by an auditor's opinion as to the fairness of the representations of management.
2. Review the auditor's report and determine: a. The type of opinion accompanying the financial statements. b. Whether there are any other deficiencies cited by the auditors which may have a bearing on the reliability of the financial management systems, etc. c. If the auditor's report pertains to management services provided or functional reviews performed, ascertain whether any of the findings and conclusions significantly affect the accounting or financial management systems.	2. a. If the auditor's opinion is not unqualified, it may be necessary to perform an evaluation of its effect on the content and reliability of the financial statements and the accounting system in operation. b. Issues dealing with financial data representations should be carefully reviewed since such comments may reflect on the ability of the prospective awardee to perform under the project. c. If the report refers to any deficiencies, the evaluator should ascertain whether corrective action, if any, has been taken.
3. Evaluate other data reported by the auditor.	3. Audit reports may include other useful information such as summary statements or other data which provide a description of the organization's major projects. – Such information may be used to identify other Federal awards, verify applicant responses, determine whether other similar or closely related projects are being performed, etc.

Blank Page

Chapter XVI

FILE DOCUMENTATION

I. Introduction

This chapter is concerned solely with the types of documentation that should be maintained resulting from the performance of cost analyses or other types of financial reviews as required by GAM Part PHS: 101 for all PHS grant programs and by the applicable Federal Acquisition Regulations in the case of contracts. It is not intended to preclude or duplicate programmatic documentation under HHS or PHS agency regulations.

II. General

For purposes of this chapter, file documentation is a method used to support and justify recommendations resulting from the financial reviews of proposed PHS awards. Documentation of financial evaluations includes the accumulation of all data relating to the performance of cost analyses, accounting system surveys, and any other reviews performed to evaluate the acceptability of cost proposals submitted to PHS.

Working papers prepared by the evaluator in support of, or to substantiate the review performed, contain information from accounting records, statistical data, personal observations, results of interviews and inquiries, and other available sources. Working papers may also include contract or grant briefs, copies of correspondence, organization charts, copies of written policies and procedures, and other substantiating documentation.

The preparation of working papers assists the evaluator in accomplishing the objectives of the review. Working papers document the evaluator's tests, analyses, verifications, conclusions, and recommendations stemming from the review(s) performed.

III. Need to Maintain Adequate File Documentation

Adequate file documentation must be maintained to:

- A. Provide a record of the work performed by the cost evaluator for use as substantiating data in the project award process.
- B. Provide guidance for subsequent evaluations.
- C. Provide a source of information to the evaluator in discussing financial aspects of the project under review with the prospective awardee.
- D. Encourage consistency in the types of financial information obtained and used in evaluating cost proposals throughout PHS.

- E. Provide a ready source of information to operating personnel within HHS and other Federal agencies on matters pertaining to particular awards or organizations.
- F. Provide substantiating data to the General Accounting Office and the HHS Office of Audit (HHS/OA) as to the adequacy of reviews performed.
- G. Serve as a basis for the review and evaluating by supervisory personnel of the work performed by the evaluator.

IV. Contents of Working Papers Files

Working papers are generally classified into two categories, the permanent or institutional file and the award or current file. Determination as to the type of documentation that is placed in each file depends on the nature of the information contained in the working papers. General guidance as to the contents in each file is presented in the ensuing paragraphs.

A. *Permanent or Institutional File*

1. The permanent or institutional file provides basic information which may be used in performing subsequent reviews of the same awardee. It provides evaluators, supervisors, and other personnel with a summary of the awardee's current policies and organizational structure. The permanent or institutional file should be maintained on a current basis by updating the file as additional information is obtained as a result of any subsequent cost analysis or financial evaluation effort.
2. The purposes of maintaining a permanent or institutional file are:
 - a. To provide a financial history of the awardee.
 - b. To provide a reference for continuous and recurring items.
 - c. To reduce the preparation of working papers for items which have not changed since the evaluation of the preceding award.
3. The permanent or institutional file may contain the following types of data:

<i>Items</i>	<i>Comments</i>
1. Index	1. This is detailed alphabetical and/or numerical list of the file contents, with reference to page location in the file.
2. Current data on pre- and post-award surveys of the organization's accounting system, financial condition, operating procedures, and practices.	2. A record of a pre- or post-award survey is one of the most important sources of information in the permanent file. These data are essential to the cost analyst in determining the financial capability, adequacy of accounting system, and operating procedures when performing cost evaluations.

The pre- and post-award survey is defined as a site visit conducted by the analyst or other authorized representative before or after an

award is made. It consists of the overall review of the organization's accounting practices, current policies and procedures, internal controls, time and effort reporting requirements, and financial condition and viability of the organization, etc.

3. Certified and internal financial and other management reports and statements.
4. Organizational and functional charts showing the line of authority and responsibility of officers and key personnel.
5. Extracts of minutes of directors, stockholders, executives, and operating committees' meetings.
6. Indirect cost negotiation agreements.
7. Cognizant Government audit agency.
8. Government audit reports.
3. Such data may provide a guide concerning the condition of the organization under review based on results of past performance and alert the evaluator to potential problem areas due to inadequate internal controls, deficient management policies, etc.
4. These charts, which give the names and positions of all individuals who are directly in charge of the various departments or branches, are helpful when line of authority in the organization's structure is desired.
5. The examination of relevant minutes of meetings of directors, committees, etc., is of importance in determining whether policy decisions adopted are being implemented by management. Matters of interest in the minutes are those that bear upon the organization's operations in accordance with authorizations passed.
6. Copies of indirect cost rate agreements affecting the prospective awardee should be maintained in the file on a current basis.
7. Many organizations have an assigned cognizant Government audit agency. In the case of colleges and universities and State and some local government agencies, audit cognizance is assigned by the Office of Management and Budget. For other organizations, audit cognizance is assumed by the Government agency having the preponderance of funding. The information obtained through the cognizant audit agency (when possible) is of utmost importance since it can provide a means for verifying various cost elements when performing evaluations.
8. Audit reports express the belief or opinion of the audit agency as to the programmatic aspects and the propriety of financial statements. These reflect the weaknesses or strong points of operating condition of the

- organization and include recommendations or actions to be taken in correcting present conditions.
9. List of grants, contracts, and subcontracts with Government agencies.
 9. A list of Government grants, contracts, and subcontracts enables the cost analyst to determine the extent of Government business with the prospective awardee.
 10. Articles of incorporation.
 10. These identify the organization as being a legal entity operating under a grant of authority from State or other political authority, either in the form of articles of incorporation or a charter. This document should be an integral part of the permanent file.
 11. Reports or information on (a) adequacy of internal control and financial capability, (b) fringe benefits, (c) types of costs normally charged, (d) direct labor policy, salary ranges, position description, job titles, (e) travel policy, and (f) contracts, grants and other data that may aid in future analyses.
 11. The information obtained either in writing, by phone, or in person must be documented. These data are extremely valuable when performing a cost evaluation as it provides basic cost and policy information that is essential in the evaluation process. Additionally, once such information is incorporated in the permanent file, the time needed for future cost analyses is reduced substantially allowing the analyst to concentrate on matters not previously discussed or mentioned.

B. Official Grant or Current Contract File

1. The current file usually consists of all working papers, data, and correspondence accumulated during the performance of a cost analysis or other financial review.
2. The purpose of maintaining an award or current file is to document and support the basis for the recommendations of the evaluator relating to a cost analysis or other type of financial review performed.
3. The award or current file usually includes:

<i>Items</i>	<i>Comments</i>
1. Index	1. This is a detailed alphabetical and/or numerical listing of the file contents, with reference to page location in the file.
2. Request(s) for assist audits to be performed by other activities.	2. A copy(ies) of the request(s) must be submitted to HHS/OA or any other activity for the performance of cost analyses or other types of financial reviews.

3. Assist audit report(s).
4. Contract or grant proposal under review.
5. PHS program office's comments and/or other information provided.
6. Notes, letters, memoranda of conferences, and/or conversations with the grantee/contractor or other Government personnel, etc.
7. Copies of requests for documentation made to the prospective awardee.
8. Summary of the cost evaluator's findings and recommendations.
9. Documentation for each proposed cost element or financial aspect which has been reviewed.
3. Assist audit report(s) are submitted by HHS/OA or any other activity in response to request(s) made by the cost evaluator.
4. A copy of the contract or grant budget proposal under review and all schedules, statements, and other pertinent information should be maintained in the file.
5. This includes all correspondence and records of conversations between the evaluator and the PHS program office affecting the outcome of the project under review.
6. The information obtained through all mentioned sources should be documented and retained in the award or current file.
7. If additional material or information is required from the prospective awardee, a record of the action (e.g., date, type of information, person contacted) should be maintained until such time as all information has been received.
8. This workpaper summarizes the evaluator's examination, analyses, verifications, conclusions, and action recommendations.
9. These data include worksheets or supporting schedules substantiating the findings and recommendations for each cost element or financial aspect reviewed.

Chapter XVII

SOURCE MATERIAL

The following documents are intended to provide additional sources of reference in the performance of financial evaluations.

- PHS Grants Administration Manual
- Code of Federal Regulations, Title 45, Part 74, Administration of Grants
- Federal Acquisition Regulations
- HHS Acquisition Regulations
- Indirect Cost Guides
 - A Guide for Colleges and Universities (OASC-1), September 1974
 - A Guide for Hospitals (OASC-3), July 1974
 - A Guide for Nonprofit Institutions (OASMB-5 Revised), May 1983
 - A Guide for State and Local Government Agencies (OASC-10), December 1976
- PHS Grants Policy Statement and
 - PHS Grants Policy Statement Addendum

Scientific Catalogs

- Fisher Scientific - Complete Chemical Products
711 Forbes Avenue
Pittsburgh, PA 15219
Phone: (412) 562-8300
- Scientific Products Division - Scientific Instruments
1430 Waukegan Road
McGaw Park, IL 60085
Phone: (312) 973-3600
- Flow Laboratories - Tissue Culture Products
7655 Old Springhouse Road
McLean, VA 22102
Phone: (703) 893-5900
- Hewlett Packard - Measurements/Computation Electronic Instruments and Systems
1501 Page Mill Road
Palo Alto, CA 94304
Phone: (415) 856-1501

-Gibco Laboratories - Tissue Culture Products
3175 Staley Road
P.O. Box 68
Grand Island, NY 14072
Phone: (716) 773-0700

-Bellco Glass, Inc. - Biological Glassware and Equipment
Vineland, NJ 08360
Phone: (609) 691-1075

Other Source Material

- GAM Part PHS: 104, "Required Documentation Under PHS Grant Programs"
- GAM Part PHS: 105, "Monitoring the Performance of Discretionary Grants." (This Chapter should be used in conjunction with GAM Part PHS: 101, See Chapter II 2.b., of this Manual.)
- OMB Circular A-21, "Cost Principles for Educational Institutions"
- OMB Circular A-87, "Cost Principles for State and Local Governments"
- OMB Circular A-122, "Cost Principles for Nonprofit Organizations"
- 48 CFR Part 31, "Contract Cost Principles and Procedures"

