TO: Organizations Receiving Grant Awards

FROM: Laura Davis, Inspector General

SUBJECT: Audit Readiness

Congratulations on receiving a grant award from the National Endowment for the Humanities (NEH). You can be proud of this accomplishment since the competition for NEH grants is intense.

The purpose of this letter is to provide guidance that would assist recipients of NEH grants in avoiding any difficulties if the organization's NEH grants are selected for audit.

By way of background, a central purpose of the Inspector General Act of 1978, as amended, is to prevent waste, fraud, abuse and mismanagement of Federal funds. We believe we can best carry out this mandate - and prevent future audit findings - by helping you to understand the Federal requirements governing NEH grants. Unfortunately, Federal auditors have found that grant recipients are not familiar with the requirements governing their awards. This unfamiliarity has resulted in findings that may require the return of some or all of the Federal funds received.

The Federal Offices of Inspectors General (OIG) conducted a study of audits performed by independent public accountants (IPAs) pursuant to Office of Management and Budget (OMB) Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations. The OIGs found that the IPAs were not meeting auditing standards established by the U. S. Government Accountability Office. In response to the study, the accounting profession has made changes and has established strict consequences to ensure that IPAs meet the government standards. Accordingly, IPAs are conducting OMB Circular A-133 audits in a more diligent manner than previously. Unless grantees follow the guidelines established for recipients of Federal awards, the IPAs will have more audit findings and costs questioned than in previous audits.

In the past, Federal auditors have found that audit findings generally relate to four areas common to many grantees:

1. Compliance with Federal grant requirements;
2. Internal controls;
3. Maintenance and retention of accounting records; and
4. Staff turnover.

Please see Attachment 1 at the end of this letter for specific areas that frequently result in questioned costs.

**Compliance with Federal Grant Requirements**

When an organization receives Federal funds, it assumes definite responsibilities. There are certifications that the organization signs when submitting a grant application. In addition, the
first drawdown of Federal funds triggers acceptance of the terms and conditions of the grant award. These actions indicate that persons within the organization are familiar with the Federal requirements and are in a position to assure that the organization complies with the grant terms and conditions.

Generally, staff must be familiar with:

- The certifications in the application package.
- The specific NEH terms and conditions stated in the award letter and attachments.
  - NEH’s General Terms and Conditions for Awards to Organizations
  - 2 CFR Part 215, Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals, and other Non-Profit Organizations (OMB Circular A-110)
  - 2 CFR 230, Cost Principles for Nonprofit Organizations (OMB Circular A-122)
  - OMB Circular A-133, Audits of States, Local Governments, and Nonprofit Organizations. (This is the audit requirement if your organization expends $500,000 or more of Federal funds in a fiscal year.)

**Internal Controls**

The organization must develop written procedures and policies concerning:

- Segregation of duties appropriate for safeguarding assets and ensuring that charges to NEH grants are allowable, reasonable, and allocable.

- The obligation of funds by certain key individuals such as the project director, the person responsible for signing checks, and the person(s) who would be a second signature for checks over a certain dollar amount.

- Documentation that must be maintained.

- Approval for travel and the maintenance of employee expense reports that capture the total cost of employee travel.

- A real structure of internal review of expenses and compliance by a person on the Board of Directors.

**Maintenance and Retention of Accounting Records**

OMB Circular A-110 requires recipients of Federal funds to be responsible for recordkeeping/accounting and proper record retention. Accounting records should provide a clear audit trail of the sources and uses for all grant funds and cost sharing.

Board of Director minutes and other committee records that mention the receipt, progress, and completion of the award should also be maintained.

If you have specific questions concerning the allowability of costs under the NEH award, you should contact the Office of Grant Management (OGM) at (202) 606-8494 or grantmanagement@neh.gov, or the program officer assigned to your grant.
**Staff Turnover**

We have found that audit problems occur when there is turnover in key positions (executive director, project director, grant administrator or bookkeeper). Naturally, this is something an organization may not be in a position to prevent. Therefore, maintaining first-rate records so that a new administrator can easily determine the status of a grant is crucial. An accounting manual that explains the accounting routine for Federal awards and the documentation requirements would also facilitate successful transitions in staff.

Upon any change of executive director or grants administrator, NEH’s program staff and OGM must be informed. It is advisable for a new bookkeeper or accountant to contact the OGM for consultation concerning the terms and conditions of a grant award. This may prevent many problems that lead to adverse audit findings.

To prevent problems that might show up in a future audit, you and any staff involved with the grant should:

1. Become familiar with the terms and conditions outlined in the grant award letter and attachments.
2. Consult with NEH staff when any uncertainty arises, or when there is a change in staff responsible for administering the grant.
3. Maintain sufficient and creditable documentation that can withstand audit and be passed on to new staff members.

Again, congratulations on your grant. NEH staff is happy to assist you in the successful completion of your grant project. You can contact your NEH program officer, OGM at (202) 606-8494 or grantmanagement@neh.gov, or you may contact the OIG. We wish you every success with your NEH grant.
Attachment 1
Organizations Receiving Grant Awards
Specific Areas for Audit Findings

- Salary and wage charges must be supported by time and effort records reflecting an after-the-fact representation of each employee’s actual activity. The effort report should be signed by the employee and/or the supervisor and coincide with the payroll period. Budget estimates do not qualify as support, and the auditor will question these costs. Each individual charged to the grant, in whole or in part, is required to maintain effort reports. 2 CFR 230, Appendix B, Paragraph 8m, Support of Salaries and Wages details time and effort reporting requirements.

- 2 CFR 215, Section 215.23, Cost Sharing or Matching, explains that cost sharing is subject to the same allowability criteria as charges to the Federal award.

- Unallowable costs must not be charged to Federal awards. 2 CFR 230 discusses the allowability of costs under Federal awards. Unallowable costs include, but are not limited to, entertainment expense, lobbying, bad debts or allowance for doubtful accounts, fines and penalties, losses on Federal or non-Federal projects, provisions for contingencies, and charitable contributions.

- Financial status reports must be reconcilable to the general ledger and worksheets should be maintained showing a clear audit trail for grants that overlap more than one fiscal year of the organization. Sufficient supporting documentation for charges to the grant should also be maintained. 2 CFR 215, Section 215.21, Standards for Financial Management Systems explains how accounting records must be maintained.

- Indirect or overhead costs must be accounted for consistently. If indirect costs are allocated to the Federal award, then the accounting records must also reflect allocation of indirect costs to other projects for which there are no reimbursements for indirect costs. If a funding source for a project does not allow reimbursement of indirect costs, then a proportionate share of indirect costs is still allocable to the project. Conversely, when expense items are directly charged to the NEH grant, then similar expenses must also be specifically identified and directly charged to other projects/programs of the organization. For example, if long-distance telephone costs are directly charged to the NEH grant, then all long distance costs incurred for other projects/programs of the organization must be directly charged to the benefiting projects/programs. The most common element of indirect cost that is subject to manipulation is “occupancy”. If an organization’s IDC rate was developed with occupancy included in the indirect cost pool, then subsequent direct charge of occupancy costs to the grant would result in an over-recovery and effect double charging of occupancy costs.