Final Independent Accountants' Report on Applying Agreed Upon Procedures to Grant Agreement Expenditures

Grant CO-13398
The Nature Conservancy
Arlington, Virginia

Submitted to the
OFFICE OF INSPECTOR GENERAL
OF THE
APPALACHIAN REGIONAL COMMISSION

Report No. 02-16 (H)

Prepared by

Leon Snead & Company, P.C.
February 5, 2002

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INDEPENDENT ACCOUNTANTS' REPORT ON APPLYING AGREED UPON PROCEDURES TO GRANT AGREEMENT EXPENDITURES

To the Inspector General of the Appalachian Regional Commission:

BACKGROUND AND OBJECTIVES

The Appalachian Regional Commission (ARC) is a regional economic development agency representing a unique partnership of Federal, state, and local government. The ARC is composed of the Governors of the 13 Appalachian states and a Federal Co-Chair appointed by the President. The geographical boundaries of the Appalachian Region extend from the southern tier counties in central and western New York to the northern counties in Alabama and Mississippi.

Each year Congress appropriates funds that ARC allocates among its member states in line with an allocation formula which is intended to provide a fair and reasonable distribution of available resources among the 13 Appalachian member states.

The Appalachian Regional Commission (ARC) awarded Grant CO-13398 to The Nature Conservancy (TNC) to provide funds to support the start-up of a Forest Bank to promote sustainable forest practices and value added processing in the Central Appalachian region. Grant CO-13398 provided up to $100,000 for the funding for these costs, with a period of performance from July 1, 1999 through June 30, 2001. The grant also stipulated that the non-ARC matching funds in the form of cash, contributed services or in-kind contributions be made.

Leon Snead & Company, P.C. is under contract to the Office of Inspector General (OIG) of the ARC to provide audit services. We performed agreed upon procedures on the grant expenditures reported to the ARC for the period July 1, 1999 through June 30, 2001. The objectives of our agreed upon procedures were to determine whether the reported grant expenditures were allowable, allocable, and reasonable and whether the grantee was in compliance with applicable laws and regulations.

SCOPE AND METHODOLOGY

We performed the procedures enumerated below, which were agreed to by the Inspector General of the Appalachian Regional Commission solely to assist you in evaluating grant expenditures by the grantee. This agreed-upon procedures engagement was performed in accordance with standards established by the American Institute of Certified Public Accountants. The sufficiency of these procedures is solely the responsibility of the specified users of the report.

Consequently, we make no representation regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested or for any other purpose.

The provisions of Office of Management and Budget (OMB) Circular A-133 "Audits of States, Local Governments, and Non-Profit Organizations"; OMB Circular A-110 "Uniform Administrative Requirements for Grants and Agreements with Institutions, of Higher Education, Hospitals, and Other Non-Profit Organizations"; OMB Circular A-122, "Cost Principles for Non-Profit Organizations", the Federal Drug-Free Workplace Act of 1998 (Public Law 100-690); the Federal Anti-Lobbying Act (Public Law 101-121); the Federal Acquisition Regulations (FAR); other Federal, state, or local procedures designed to insure fair and non-discriminatory procedures were used for the selection of participants; agreed to procedures that emphasize the expenditure of grant funds in line with the provisions of the grant agreement; and the ARC Code were used as the basis for determining allowable costs and compliance requirements. These agreed upon procedures were performed in accordance with generally accepted auditing standards and *Government Auditing Standards*, 1994 version, as amended, issued by the Comptroller General of the United States.

We were not engaged to, and did not, perform an examination, the objective of which would be the expression of an opinion on the financial statements of the grantee. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

We visited The Nature Conservancy (TNC) offices in Arlington, Virginia during the period January 22, 2002 through January 25, 2002.

Specifically we performed the following procedures:

- We discussed the grant expenditure process and internal controls with the TNC Headquarters officials in Arlington, Virginia.

- We reviewed the available detail support for $99,009 (99%) of the reported expenditures charged to ARC Grant CO-13398 between July 1, 1999 (the grant period of performance starting date) and June 30, 2001 (the grant period of performance ending date) and tied the grant expenditures to the supporting TNC Labor Distribution schedules, subcontract agreements, voucher transmittal documents, Travel Expense Reports, equipment cost-benefit analysis, incurred expense documents, vendor invoices, and other supporting documents.

- We reviewed the available detail support for all of the $2,042,224 in reported governmental, grantee and private sector grant matching expenditures.

- We compared the grant expenditures made with the project budget for the grants to determine if grant funds were spent only on items which were included in the original project budget, and if ARC approval had been requested and obtained for any items not included in the original project budget.

- We reviewed documentation supporting the grantee's efforts to achieve the programmatic objectives of the grant.

RESULTS

We noted the following exception:

1) *Questioned Cost - Overhead*

Condition

The Grantee claimed $3,205 in excess overhead expense due to the inclusion of fringe benefits within the base calculation.

Criteria

(1) U.S. Agency for International Development (USAID) February 27, 1998 "Negotiated Indirect Cost Rate_Agreement"

Discussion

We found that the grantee claimed overhead expense on an indirect cost, fringe benefits.

The USAID "Negotiated Indirect Cost Rate Agreement" specifies under "Base of Application" that the Indirect Cost shown as "Domestic (& Int'l, Excluding Pacific)", i.e. the overhead rate, should have a base that is "Total direct costs except direct cost of Pacific Region".

The TNC included a total of $16,433 of fringe benefits as part of the base upon which total overhead expense was calculated. Thus, total excess overhead expense billed to the ARC is calculated as follows:

Total fringe expense	$16,433
Less non-ARC cost	407
Net fringe billed to ARC	16,026
Overhead rate	20%
Excess overhead	$ 3,205

Recommendation

ARC should request a refund of $3,205 for excess overhead billed to the ARC. These costs are not allowable under the USAID "Negotiated Indirect Cost Rate Agreement".

Grantee's Comments

As detailed in the draft report, the auditor found that the Conservancy claimed overhead expense on an indirect cost, fringe benefits. While we understand the confusion that the presentation of our negotiated rates with TNC's cognizant agency, the U.S. Agency for International Development (USAID), may present, fringe benefits are a direct cost of the ARC grant. The negotiation of a fringe benefit rate with USAID allows us to calculate the approved rate as a direct cost on regular salary expenses charged to this project.

In calculating the indirect costs for the organization, we are able to segregate our costs into direct cost pools and indirect cost pools, based on the type of activities carried out by the Conservancy. Fringe benefits are costs incurred in both pools. Our indirect cost rate of 20% is derived by taking our general and administrative costs or our indirect costs and dividing that by our programmatic or direct costs. Our fringe rate of 35.4% is derived by totaling all costs for all allowable benefits and then dividing this number by total regular salaries. The fringe rate allows us to spread these costs across the various activities and projects carried out by staff throughout the organization. As required by OMB Circular A-122, fringe benefits "are absorbed by all organization activities in proportion to the relative amount of time or effort actually devoted to each," are "distributed to particular awards and other activities in a manner consistent with the pattern of benefits accruing to the individuals or group of employees whose salaries and wages are chargeable to such awards and other activities," and the benefits "are granted in accordance with established written organization policies." We consistently treat fringe benefits as a direct cost of all Conservancy activities.

In addition, the Conservancy submitted a proposal and budget to ARC when applying for the grant funds. The budget clearly showed that indirect costs were to be applied to all costs associated with the project (personnel, fringe benefits, travel, equipment, and contractual costs.) ARC approved this budget, therefore accepting and agreeing to these costs.

Finally, even if ARC were to determine that TNC should have excluded fringe benefit costs when determining the amount of indirect costs to charge to the award, there were costs in excess of the award amount that were not billed to ARC but were, nonetheless, allowable costs. ARC awarded $100,000 to this project and total expenses for this project were $101,789.59 (includes indirect costs applied to all costs), resulting in an overrun of $1,789.59. This amount was absorbed by the Conservancy and was not billed to ARC. Although we consistently charge indirect costs on fringe benefits and disagree that this is an unallowable cost, the amount of the overrun represents more than half of the disputed amount and can be used as a substitute, if necessary.

Accountants' Response

We are not persuaded that fringe benefits were a direct cost. The indirect rate agreement of the cognizant agency is controlling.

CONCLUSIONS

Based on the results of our agreed upon procedures, in our opinion $96,795 of the $100,000 in grant fund expenditures incurred between July 1, 1999 and June 30, 2001 which were charged to the ARC for Grant CO-13398 were allowable, allocable and reasonable and should be accepted by the ARC. There were $3,205 in unallowable indirect costs charged to the ARC.

DISTRIBUTION

This report is intended for the information and use of the OIG and management of the ARC and should not be used for any other purpose. However, this report is a matter of public record and its distribution is not limited.

Leon Snead & Company, P. C.
LEON SNEAD & COMPANY, P. C.
February 5, 2002

GRANTEE'S COMMENTS

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March 18, 2002

Ms. Alexis M. Stowe
Vice President
Leon Snead & Company, P.C.
416 Hungerford Drive, Suite 400
Rockville, MD 20850

Subject: Comments on Draft Report No. 02-16(H)

Dear Ms. Stowe:

The Nature Conservancy appreciates the opportunity to comment on the questioned cost outlined in your Draft Report No. 02-16(H) for the Appalachian Regional Commission concerning Grant CO-13398, Nature Conservancy Center – Forest Bank, Virginia.

As detailed in the draft report, the auditor found that the Conservancy claimed overhead expense on an indirect cost, fringe benefits. While we understand the confusion that the presentation of our negotiated rates with TNC's cognizant agency, the U.S. Agency for International Development (USAID), may present, fringe benefits are a direct cost of the ARC grant. The negotiation of a fringe benefit rate with USAID allows us to calculate the approved rate as a direct cost on regular salary expenses charged to this project.

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Please contact Lynn McKenna, Grants Specialist for this grant, at 703-247-3728 if you require additional information about this issue. We hope this explanation is sufficient to merit inclusion of these costs in the direct cost pool of the project and therefore, calculating indirect costs on all direct costs.

Sincerely,

Tamar Datan
Vice-President and Director, Compatible Ventures Group

Cc: Lynn McKenna
Hilary Toma