

**UNCLASSIFIED**

United States Department of State  
and the Broadcasting Board of Governors  
Office of Inspector General

## **Office of Audits**

# Independent Accountants' Report on the Application of Agreed-Upon Procedures on Indirect Cost Rates Proposed by AFS-USA, Inc.

Report Number AUD/CG-10-15, January 2010

### **~~IMPORTANT NOTICE~~**

~~This report is intended solely for the official use of the Department of State or the Broadcasting Board of Governors, or any agency or organization receiving a copy directly from the Office of Inspector General. No secondary distribution may be made, in whole or in part, outside the Department of State or the Broadcasting Board of Governors, by them or by other agencies or organizations, without prior authorization by the Inspector General. Public availability of the document will be determined by the Inspector General under the U.S. Code, 5 U.S.C. 552. Improper disclosure of this report may result in criminal, civil, or administrative penalties.~~

**UNCLASSIFIED**

UNCLASSIFIED

United States Department of State  
and the Broadcasting Board of Governors  
Office of Inspector General

Office of Audits

Independent Accountants' Report on the Application of Agreed-Upon  
Procedures on Indirect Cost Rates Proposed by  
AFS-USA, Inc.

Report Number AUD/CG-10-15, January 2010

L.F. Harris & Associates, CPA, P.A., performed the agreed-upon procedures under the Department of State, Office of Inspector General, Contract No. S-AQMPD-04-D-0044, and by acceptance the report becomes a product of the Inspector General.



---

Harold W. Geisel  
Deputy Inspector General

FEB -3 2010

---

Date

~~IMPORTANT NOTICE~~

~~This report is intended solely for the official use of the Department of State, Broadcasting Board of Governors, or any agency or organization receiving a copy directly from the Office of Inspector General. No secondary distribution may be made, in whole or in part, outside the Department of State, the Broadcasting Board of Governors, or by other agencies or organizations without prior authorization by the Inspector General. Public availability of the document will be determined by the Inspector General under the U.S. Code, 5 U.S.C. 552. Improper disclosure of this report may result in criminal, civil, or administrative penalties.~~

UNCLASSIFIED

## UNCLASSIFIED

### Summary

At the request of the Department of State, Office of Inspector General (OIG), L.F. Harris & Associates, CPA, P.A., performed certain agreed-upon procedures to determine whether AFS-USA, Inc.'s proposed indirect cost rates for the fiscal years ended December 31, 2007, 2006, and 2005, complied with applicable regulations.

We found AFS-USA's accounting system to be adequate for the purpose of accumulating and reporting indirect costs under the provisions of Office of Management and Budget (OMB) Circular A-122 at 2 CFR Part 230, *Cost Principles for Non-Profit Organizations*, and Circular A-110, *Uniform Administrative Requirements for Grants and Agreements With Institutions of Higher Education, Hospitals, and Other Non-profit Organizations*.

Our review disclosed that for the three fiscal years, the indirect cost rates reported by AFS-USA contained errors and inconsistencies in the rate calculations. Our review noted three instances of noncompliance with the requirements of OMB Circular A-122. The three findings and appropriate adjustments are summarized in the Results section of this report. We recommend that the Department accept and finalize the indirect cost rates for FYs 2007, 2006, and 2005 as we computed them and as they are presented in Table 2 of this report.

### Background

AFS-USA, Inc., is a nongovernmental, not-for-profit organization incorporated under the laws of Illinois and is a tax-exempt organization under the Internal Revenue Code Section 501 (c) (3) of the United States of America. Since 1993 AFS-USA has been operating under the Articles of Partnership—a signed agreement of cooperation between AFS-USA and AFS International—which essentially allows AFS-USA the exclusive right to operate AFS-branded programs in the United States as long as AFS-USA abides by the agreed-upon global standards. AFS partner organizations are incorporated under the laws of the countries in which they are located, and they prepare financial statements and tax reports as required by the jurisdictions in their respective countries.

Each partner undergoes an annual fiscal audit and presents to AFS International a copy of the independent auditor's opinion along with the financial statements. While rules and regulations vary among partner organizations, audits are conducted in accordance with auditing standards generally accepted in the United States of America. Financial statements are presented in conformity with the U.S. generally accepted accounting principles. According to AFS-USA, Inc.,<sup>1</sup> AFS partner organizations provide intercultural learning opportunities "to help people develop the knowledge, skills, and understanding needed to create a more just and peaceful world."

During the fiscal years ended December 31, 2007, 2006, and 2005, AFS-USA entered into the grant agreements with the Department shown in Table 1.

---

<sup>1</sup> <[linkedin.com/companies/afs-usa-inc](http://linkedin.com/companies/afs-usa-inc)>, accessed on December 30, 2009.

**UNCLASSIFIED**

**Table 1. Grants Awarded to AFS-USA—FYs 2007, 2006, and 2005**

<b>Grant Title/Number</b>	<b>Period of Grant</b>	<b>Grant Amount</b>
Partnership for Learning Youth Exchange and Study (YES)		
S-ECAPY-07-GR-162 (MA)	08-27-2007 to 12-31-2009	\$6,599,496
Global Leadership in the 21 <sup>st</sup> Century: Identity, Diversity, Respect and Opportunity		
S-ECAPY-07-GR-148 (LM)	08-22-2007 to 03-31-2008	\$164,966
Summer Language Institute for American Youth—Egypt		
S-ECAPY-07-GR-095 (SS)	05-04-2007 to 12-31-2007	\$201,937
2007/2008 Future Leaders Exchange (FLEX Program)		
S-ECAPY-07-GR-083 (LM)	04-27-2007 to 10-31-2008	\$247,499
Exchange Program for School Principles From Bolivia		
S-ECAAS-06-CA-231 (DT)	09-21-2006 to 09-30-2008	\$247,049
Conduct a Youth Exchange and Study (YES) Program		
S-ECAPY-06-GR-173 (CS)	09-01-2006 to 12-31-2008	\$5,525,338
Summer Language Institute for American Youth		
S-ECAPY-06-GR-082 (DH)	04-20-2006 to 12-31-2006	\$99,997
2006/2007 Future Leaders Exchange (FLEX Program)		
S-ECAPY-06-GR-062 (LM)	03-10-2006 to 10/31/2007	\$254,455
Congress–Bundestag Youth Exchanges Program Year 2006/2007		
S-ECAPY-06-GR-042 (DH)	02-13-2006 to 08-31-2007	\$477,940
Partnership for Learning Youth Exchange and Study (P4I YES)		
S-ECAPY-05-GR-174 (DH)	09-19-2005 to 09-30-2006	\$4,938,667
2005-2006 Congress– Bundestag Youth Exchange Program		
S-ECAPY-05-GR-038 (PS)	02-25-2005 to 08-31-2006	\$447,952
Partnership for Learning Youth Exchange and Study (YES)		
S-ECAPY-05-GR-044 (MA)	02-18-2005 to 09-30-2006	\$3,211,745
Partnership for Learning Youth Exchange and Study (YES)		
S-ECAPY-04-GR-075 (MA)	04-13-2004 to 08-31-2005	\$2,201,211
2004 Congress–Bundestag Youth Exchange Initiative		
S-ECAPY-04-GR-068 (PS)	03-17-2004 to 07-31-2005	\$544,000
Future Leaders Exchange (FLEX) Program of the Freedom Support Act NIS Secondary School Initiative		
S-ECAPY-04-GR-095 (JJ)	05-03-2003 to 10-31-2005	\$100,000

**UNCLASSIFIED**

Partners in Understanding Youth Exchange Initiative Program		
S-ECAPY-03-GR-092 (JL)	04-21-03 to 07-31-2006	\$2,949,426
<b>Total Awards</b>		<b>\$28,211,678</b>

The Department gave AFS-USA permission to use provisional indirect cost rates. Provisional rates are temporary rates used for funding and billing indirect costs pending the establishment of a final rate for a specified time period. The grants specify that AFS-USA is subject to the requirements of OMB Circulars A-110; A-122; and A-133, *Audits of States, Local Governments, and Non-Profit Organizations (Compliance Supplement)*.

**Purpose, Scope, and Methodology**

The primary purpose of this agreed-upon procedures engagement was to determine whether AFS-USA’s indirect cost structure for FYs 2007, 2006, and 2005 complied with applicable regulations.

OMB Circular A-122 establishes principles and standards for determining costs for Federal awards carried out through grants, cost-reimbursement contracts, and other agreements with not-for-profit organizations. These principles are for the purpose of cost determination and are designed to ensure that Federal awards bear their fair share of costs.

The principles and standards of OMB Circular A-122 apply to both direct and indirect costs. A direct cost is a cost that can be identified specifically with a particular cost objective; for example, employee compensation and benefits, supplies, and travel. An indirect cost is a cost that cannot be identified with a single, final cost objective but is identified with two or more final costs objectives, one or more of which benefit Federal programs. Such costs should be combined into groups or pools and should be distributed to benefit final cost objectives in a manner that will produce an equitable result based on relative benefits derived.

We designed our approach to determine compliance with OMB Circular A-122, which describes selected cost items, allowable costs, and standard methodologies for calculating a nonprofit organization’s indirect cost rates. The purposes of OMB Circular A-122 are to

- ensure that the Federal Government bears its fair share of costs,
- identify allowable costs for determining the actual cost of federal programs, and
- establish policies and procedures for indirect cost allocation plans

Our procedures included the following:

1. Determining that charges to cost pools used in calculating indirect cost rates were mathematically accurate and supported by the grantee’s accounting records and audited financial statements,

## UNCLASSIFIED

2. Assessing the allowability and allocability of indirect costs by reviewing supporting documentation for selected transactions and inquiring about the nature and functions of activities included in the indirect cost pool,
3. Assessing the causal and beneficial relationship between indirect costs and costs activities,
4. Analyzing the allowability and allocability of accounts comprising AFS-USA's fringe benefit pool,
5. Reviewing the general ledger to determine whether the grantee had income and credits and whether they were credited to the indirect costs or fringe benefit pools as appropriate,
6. Inquiring about applicable fiscal year operations and assessing the impact of changes on the indirect cost rate structure, and
7. Determining whether the grantee's accounting system is adequate to properly identify and segregate direct and indirect costs as well as allowable and unallowable costs.

Our approach to addressing the procedures was as follows:

1. We obtained an understanding of internal control over the subject matter of this engagement through inquiry and observation, performed an assessment of risk, and tested internal controls.
2. For direct costs, we determined whether AFS-USA complied with the provisions of OMB Circular A-122 by
  - a. testing direct charges to federal awards for allowability and
  - b. verifying that unallowable costs determined to be direct costs were included in the allocation base for the purpose of computing an indirect cost rate.
3. We tested indirect costs to determine whether
  - a. the base used to distribute the approved allowable indirect cost was appropriate and reasonable and in accordance with the requirements of OMB Circular A-122;
  - b. the calculated indirect cost rate was
    - i. consistent with policies and procedures that apply uniformly to both federally funded and other activities of the organization and
    - ii. applied consistently to the proper allocation bases;
  - c. AFS-USA complied with the provisions of OMB Circular A-122 in that
    - i. charges to indirect cost pools were for allowable costs,
    - ii. the base used to distribute indirect costs included both allowable and unallowable costs, and
    - iii. the cost allocation methodology provides equitable and consistent allocation of indirect costs to benefiting awards or activities.

UNCLASSIFIED

UNCLASSIFIED

The scope of detail testing of individual accounts, internal controls, direct costs, indirect costs, regulation compliance, and other applicable records is a matter of judgment. Auditors cannot assume responsibility for fraud detection or prevention. Auditors are expected to maintain an alertness that will permit adequate inspection of the financial records as well as of the internal controls, internal accounting, and administrative controls. As such, the auditors were alert to the possibility of intentional wrongdoing, errors and omissions, inefficiency, waste, ineffectiveness, and conflicts of interest.

Results

AFS-USA’s accounting system was adequate to properly identify and segregate direct and indirect costs, as well as allowable and unallowable costs, for the years ended December 31, 2007, 2006, and 2005, under the provisions of OMB Circular A-122. However, we identified inconsistencies in the way in which cost pools were allocated or calculated. These inconsistencies resulted in questioned costs or cost increases to the cost pools, as shown in Attachment A. The proposed and auditor-computed indirect cost rates are shown in Table 2.

Table 2. AFS-USA’s Proposed Indirect Cost Rates and Our Recomputed Rates

Fiscal Year	Description	AFS Proposed Rate	Auditor-Computed Rate
2007	Indirect Cost Rate*		
2006	Indirect Cost Rate*		
2005	Indirect Cost Rate*		

\* The distribution base is modified direct costs, which are those costs that have been specifically identified to a sponsored program or a direct cost objective. The costs related to unallowed activities, such as Office of the President, fund raising, and marketing, were treated as direct costs in accordance with applicable Federal regulations and with consistency to past practice.

**Recommendation 1:** We recommend that the Bureau of Administration, Office of Logistics Management, Office of Acquisitions Management, International Programs Division, accept and finalize, as we have computed, the indirect cost rates for the fiscal years ended December 31, 2007; December 31, 2006; and December 31, 2005.

During our review, we noted three instances of noncompliance with the requirements of OMB Circular A-122. As a result, we questioned the transactions, made applicable adjustments to the cost pools, and recomputed the indirect cost rates, as shown in Attachment A and explained in the following notes:

1. AFS-USA did not appropriately capture unallowable activities in the modified direct cost pools in the amounts of \$314,210, \$6,823, and \$3,994 for FYs 2007, 2006, and 2005 respectively. These costs were erroneously included in the indirect cost pools, and as a result, both the modified direct cost pool and the indirect cost pool for each year had to be adjusted accordingly. Also, the indirect cost rates for FYs 2007, 2006, and 2005 had to be recomputed.

**UNCLASSIFIED**

2. AFS-USA erroneously excluded moving expenses in the amount of [redacted] for FY 2006 from the cost proposal. These costs are unallowable; therefore, we added [redacted] to the modified direct cost pool under miscellaneous expense in our recomputation of the indirect cost rate for FY 2006.
3. AFS-USA was not able to provide, during our testing of indirect costs for 29 items per fiscal year, adequate documentation for two items totaling [redacted] and one item totaling [redacted] selected for FYs 2006 and 2005, respectively.

Because these items were not supported, we selected three additional items from the same account balance in FY 2006 to determine whether this was a one-time occurrence of unsupported items or this was pervasive within the general ledger account balance. We found that the additional items selected were supported and that the lack of supporting documentation was not pervasive in the account balance. Therefore, the total balance for the account should not be disallowed.

The unsupported expenditure for FY 2005 was the only item charged to the account balance from which the item was selected; therefore, no additional items could be tested.

Based on the procedures performed, we adjusted the account balances for the unsupported amounts of [redacted] and [redacted] for FYs 2006 and 2005, respectively.



L.F. Harris & Associates, CPA, P.A.  
Certified Public Accountants

---

INDEPENDENT ACCOUNTANTS' REPORT ON APPLYING AGREED-UPON  
PROCEDURES

U.S. Department of State  
Office of Inspector General  
Office of Audits  
1700 North Moore Street  
Arlington, VA 22209

We have performed certain agreed-upon procedures (Procedures), as summarized in the Purpose, Scope and Methodology section of this report. The Procedures, which were agreed to by the Office of Inspector General, U.S. State Department, were performed solely to assist the Office of Inspector General, U.S. State Department in evaluating AFS-USA, Inc computations of their indirect cost rates in accordance with OMB Circular A-122, for the fiscal years ended December 31, 2007, 2006, and 2005.

The AFS-USA's management is responsible for compliance with those requirements. This agreed-upon procedures engagement was conducted in accordance with attestation standards established by the American Company of Certified Public Accountants, *Generally Accepted Governmental Accounting Standards*, and guidance from the Office of Management and Budget. The sufficiency of these Procedures is solely the responsibility of those parties specified in this report. Consequently, we make no representation regarding the sufficiency of the Procedures as described in the Purpose, Scope and Methodology section of this report, either for the purpose for which this report has been requested or for any other purpose. Our test Procedures revealed three findings. These findings and the associated recommendations are presented in the "Results" section of this report.

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

This report is intended solely for the use of the United States Department of State, Office of Inspector General, and should not be used by those who have not agreed to the Procedures, and taken responsibility for the sufficiency of the Procedures for their purposes.

*L.F. Harris & Associates*

L.F. Harris & Associates, CPA, P.A.  
September 30, 2009

AFS-USA, Inc.  
 STATEMENT OF INDIRECT COSTS  
 AND MODIFIED DIRECT COSTS  
 FOR THE YEAR ENDED DECEMBER 31, 2007

<u>Description</u>	<u>Results</u>	<u>Total Claimed Costs</u>	<u>Adjustments</u>	<u>Adjusted Cost</u>
<b>Indirect Costs</b>				
Salaries				
Employee Benefits				
Payroll Taxes				
Professional Fees & Services				
Consumable Supplies				
Communications				
Postage & Shipping				
Occupancy	1			
Equipment Rental & Purchases	1			
Printing, Publications, & Media	1			
Travel, Meals & Lodging				
Meetings & Conferences				
Membership Dues				
Participant Costs				
Insurance				
Miscellaneous				
Depreciation		—		
		=		
<b>Modified Direct Costs</b>				
Salaries				
Employee Benefits				
Payroll Taxes				
Professional Fees & Services				
Consumable Supplies				
Communications				
Postage & Shipping				
Occupancy	1			
Equipment Rental & Purchases	1			
Printing, Publications, & Media	1			
Travel, Meals & Lodging				
Meetings & Conferences				
Membership Dues				
Participant Costs				
Sponsored Programs				
Miscellaneous		—		
		=		

See Results section of this report for nature of adjustments 1-3. The following tabulation summarizes the allowable indirect cost rate incurred by the agency for the fiscal year ended December 31, 2007:

<u>Description</u>	
Indirect Cost Rate	(b) (4)

AFS-USA, Inc.  
 STATEMENT OF INDIRECT COSTS  
 AND MODIFIED DIRECT COSTS  
 FOR THE YEAR ENDED DECEMBER 31, 2006

Description		Total Claimed				Adjusted					
Indirect Costs	Results	Costs				Cost					
Salaries		(b)	(4)	(b)	(4)	(b)	(4)	(b)	(4)	(b)	(4)
Employee Benefits		(b)	(4)	(b)	(4)	(b)	(4)	(b)	(4)	(b)	(4)
Payroll Taxes		(b)	(4)	(b)	(4)	(b)	(4)	(b)	(4)	(b)	(4)
Professional Fees & Services	3	(b)	(4)	(b)	(4)	(b)	(4)	(b)	(4)	(b)	(4)
Consumable Supplies		(b)	(4)	(b)	(4)	(b)	(4)	(b)	(4)	(b)	(4)
Communications		(b)	(4)	(b)	(4)	(b)	(4)	(b)	(4)	(b)	(4)
Postage & Shipping		(b)	(4)	(b)	(4)	(b)	(4)	(b)	(4)	(b)	(4)
Occupancy	1	(b)	(4)	(b)	(4)	(b)	(4)	(b)	(4)	(b)	(4)
Equipment Rental & Purchases	1	(b)	(4)	(b)	(4)	(b)	(4)	(b)	(4)	(b)	(4)
Printing, Publications, & Media		(b)	(4)	(b)	(4)	(b)	(4)	(b)	(4)	(b)	(4)
Travel, Meals & Lodging		(b)	(4)	(b)	(4)	(b)	(4)	(b)	(4)	(b)	(4)
Meetings & Conferences	3	(b)	(4)	(b)	(4)	(b)	(4)	(b)	(4)	(b)	(4)
Membership Dues		(b)	(4)	(b)	(4)	(b)	(4)	(b)	(4)	(b)	(4)
Participant Costs		(b)	(4)	(b)	(4)	(b)	(4)	(b)	(4)	(b)	(4)
Insurance		(b)	(4)	(b)	(4)	(b)	(4)	(b)	(4)	(b)	(4)
Miscellaneous		(b)	(4)	(b)	(4)	(b)	(4)	(b)	(4)	(b)	(4)
Depreciation		(b)	(4)	(b)	(4)	(b)	(4)	(b)	(4)	(b)	(4)
		—	(b)	(4)	(b)	(4)	(b)	(4)	(b)	(4)	(4)
		—	(b)	(4)	(b)	(4)	(b)	(4)	(b)	(4)	(4)
		(b)	(4)	(b)	(4)	(b)	(4)	(b)	(4)	(b)	(4)
<b>Modified Direct Costs</b>		(b)	(4)	(b)	(4)	(b)	(4)	(b)	(4)	(b)	(4)
Salaries		(b)	(4)	(b)	(4)	(b)	(4)	(b)	(4)	(b)	(4)
Employee Benefits		(b)	(4)	(b)	(4)	(b)	(4)	(b)	(4)	(b)	(4)
Payroll Taxes		(b)	(4)	(b)	(4)	(b)	(4)	(b)	(4)	(b)	(4)
Professional Fees & Services		(b)	(4)	(b)	(4)	(b)	(4)	(b)	(4)	(b)	(4)
Consumable Supplies		(b)	(4)	(b)	(4)	(b)	(4)	(b)	(4)	(b)	(4)
Communications		(b)	(4)	(b)	(4)	(b)	(4)	(b)	(4)	(b)	(4)
Postage & Shipping		(b)	(4)	(b)	(4)	(b)	(4)	(b)	(4)	(b)	(4)
Occupancy	1	(b)	(4)	(b)	(4)	(b)	(4)	(b)	(4)	(b)	(4)
Equipment Rental & Purchases	1	(b)	(4)	(b)	(4)	(b)	(4)	(b)	(4)	(b)	(4)
Printing, Publications, & Media		(b)	(4)	(b)	(4)	(b)	(4)	(b)	(4)	(b)	(4)
Travel, Meals & Lodging		(b)	(4)	(b)	(4)	(b)	(4)	(b)	(4)	(b)	(4)
Meetings & Conferences		(b)	(4)	(b)	(4)	(b)	(4)	(b)	(4)	(b)	(4)
Membership Dues		(b)	(4)	(b)	(4)	(b)	(4)	(b)	(4)	(b)	(4)
Participant Costs		(b)	(4)	(b)	(4)	(b)	(4)	(b)	(4)	(b)	(4)
Miscellaneous	2	(b)	(4)	(b)	(4)	(b)	(4)	(b)	(4)	(b)	(4)
		—	(b)	(4)	(b)	(4)	(b)	(4)	(b)	(4)	(4)
		—	(b)	(4)	(b)	(4)	(b)	(4)	(b)	(4)	(4)

See Results section of this report for nature of adjustments 1-3. The following tabulation summarizes the allowable indirect cost rate incurred by the agency for the fiscal year ended December 31, 2006:

Description	
Indirect Cost Rate	(b) (4)

AFS–USA, Inc.  
 STATEMENT OF INDIRECT COSTS  
 AND MODIFIED DIRECT COSTS  
 FOR THE YEAR ENDED DECEMBER 31, 2005

<u>Description</u>	<u>Results</u>	<u>Total Claimed Costs</u>	<u>Adjustments</u>	<u>Adjusted Cost</u>
<b>Indirect Costs</b>				
Salaries				
Employee Benefits				
Payroll Taxes				
Professional Fees & Services				
Consumable Supplies				
Communications				
Postage & Shipping				
Occupancy	1			
Equipment Rental & Purchases				
Printing, Publications, & Media				
Travel, Meals & Lodging				
Meetings & Conferences				
Membership Dues				
Participant Costs				
Insurance	3			
Miscellaneous				
Depreciation		—		
		=		
<b>Modified Direct Costs</b>				
Salaries				
Employee Benefits				
Payroll Taxes				
Professional Fees & Services				
Consumable Supplies				
Communications				
Postage & Shipping				
Occupancy	1			
Printing, Publications, & Media				
Travel, Meals & Lodging				
Meetings & Conferences				
Membership Dues				
Participant Costs				
Miscellaneous		—		
		=		

See Results section of this report for nature of adjustments 1-3. The following tabulation summarizes the allowable indirect cost rate incurred by the agency for the fiscal year ended December 31, 2005:

<u>Description</u>	
Indirect Cost Rate	(b) (4)

**UNCLASSIFIED**

**UNCLASSIFIED**