**Standards for Inventory Management Systems**

The specific federal rules that apply to an entity’s inventory management system depend on (1) what type of entity is receiving the federal funds, and (2) whether the funds are received directly from the U.S. Department of Education (ED) or through the state.

This guide outlines the specific Education Department General Administrative Regulations (EDGAR) thresholds that apply to certain recipients of federal funds, it is perhaps more important to understand the overriding influence of the cost principles as they related to inventory management and the tracking of items purchased with federal funds. In essence, the cost principles contained in Office of Management and Budget (OMB) Circulars A-21, A-87 and A-122 require all expenditures of federal funds to be –at a minimum-necessary, reasonable, allocable to the program, allowable under the program and legal under state and local law. It is nearly impossible to demonstrate that items purchased with federal funds comply with these cost principles, and benefit the applicable program, if the times cannot be tracked and located by the federal grant recipient.

Accordingly, from a practical perspective, proper inventory management for items purchased with federal funds is reduced to the following: if a recipient purchases an item with federal funds, the recipient is best protected against adverse audit or monitoring findings if it has a system to track the item, regardless of its value. This concept will be discussed more in section II of this chapter.

**Summary of EDGAR-Specific Rules Regarding Equipment and Supplies**

From a legal perspective, as with the other two threshold systems (financial management and procurement), states and local governments (including school districts) managing state-administered programs are permitted to follow state and local inventory management procedures. Specifically, in a state-administered program, state and local governments may “use, manage, and dispose of equipment” acquired by a federal grant in a manner consistent with state laws and procedures. Other entities, such as school districts receiving funds directly from ED, must follow the specific requirements pertaining to equipment outlined in Sections 80.32(c)-(e) of EDGAR; institutions of higher education (IHEs), hospitals and nonprofits must follow Section 74.34 of EDGAR. Entities are encouraged to consult counsel to determine which standards apply in a given circumstance.

**Equipment Requirements by Grantee Type**

|  |  |
| --- | --- |
| TYPE OF GRANTEE OR SUBGRANTEE | PROCUREMENT PROCEDURES TO BE USED  (Caveat: Even where an entity is legally permitted to follow state or local equipment management procedures, it must still ensure that the basic cost principle requirements of necessary, reasonable, allocable, and legal are met, as well as other state, local and federal rules.) |
| States  Local governments receiving funds through the state | Use, manage and dispose of equipment acquired under a grant in accordance with state and local procedures. |
| Local governments receiving funds directly from ED  “Other grantees and sub grantees” | Use existing state or local procurement procedures if they comply with Sections 80.32(c)-(e) of EDGAR.  Otherwise, implement procedures specified in those Sections of EGAR. |
| Institutions of higher education  Hospitals  Other nonprofit organizations | Implement policies and procedures that comply with Section 74.34 of EDGAR. |

All recipients of federal education funds should be familiar with the specific requirements outlined in EDGAR, because ED monitors appear to be conceptually applying the EDGAR equipment standards as an internal control “yardstick” when determining whether expenditures meet federal cost principle requirements even where the EDGAR standards may not formally be required. Moreover, the Office of Inspector General (OIG) often issues findings citing agencies for having weak internal controls when property purchased with federal funds is lost or not easily accounted for through an inventory management system.

The basic threshold equipment management requirements are summarized in this section of Federal Education Grants Management. For simplicity, this summary is aligned to the organization of Sections 80.32(c)-(e) of EDGAR; entities are advised to consult the appropriate section of EDGAR that applies to their particular grant and circumstances before expending funds.

**Definition of Equipment**

As described in the definition section of Section 80.3, for state and local governments, “equipment” is tangible, nonexpendable personal property that has a useful life of more than one year and an acquisition cost of $5,000 or more. State and local governments may set a lower threshold for defining equipment, but not a higher one (many states define equipment as having an acquisition cost of $1,000 per unit). If a state or local government sets a lower threshold, such as entities, as well as other grantees and sub grantees must use that lower number for defining equipment.

EDGAR requires that grantees and sub grantees maintain controls over equipment through a compliant inventory management system. Elements of a compliant inventory management system are discussed below.

**Property Records**

Grantees and sub grantees must keep very specific records to document the location and use of equipment purchased with federal funds. A grantee or subgrantee that cannot identify each piece of equipment purchased with federal funds for an auditor risks an audit finding, even if the purchase was allowable under the relevant federal program. Inventory management findings are common, as discussed in the section below.

Under Section 80.32(d)(1) of EDGAR, grantees and sub grantees to which that section applies must maintain specific property records that include:

1. a description of the property;
2. a serial number or other identification number;
3. the source of property;
4. who holds title;
5. the acquisition date and cost of the property;
6. the percentage of federal participation in the cost of property;
7. the location, use and condition of the property; and
8. any ultimate disposition data, including the date of disposal and sale price of the property.

From a practical perspective, to facilitate proper tracking of property, grantees and sub grantees should tag any piece of equipment, as well as small and attractive items (such laptops, printers and personal digital assistants) that cost less than the equipment threshold but are easily stolen or damaged. The tag should consist of a physical label with an inventory number. It is also wise to include the funding source that allowed for the purchase (i.e., the federal or state program name or local revenue source). This is an effective mechanism for demonstrating proper recordkeeping when ED monitors or OIG auditors conduct on-site visits.

**Control System**

As part of an inventory management system, grantees and sub grantees must develop a control system to ensure that adequate safeguards are in place to prevent loss, damage or theft of the property. Any loss, damage or theft must be investigated by the grantee or subgrantee.

**Physical Inventories**

Grantees and sub grantees must take a physical inventory of their equipment at least every two years and must reconcile the results. If any equipment is missing, the grantee or subgrantee must follow up as described above. A state or local government, or the grantee’s or subgrantee’s own internal procedures, may require a more frequent physical inventory (for example, every year). If so, recipients must follow the more restrictive state, local or internal rules.

**Adequate Maintenance of Equipment**

Grantees and sub grantees must ensure adequate maintenance procedures to keep equipment purchased with federal funds in good condition. Assuming they are necessary, reasonable and properly allocated, maintenance costs can generally be charged to federal grants if they:

* keep property in efficient operating condition;
* do not add to the permanent value of the property or appreciably prolong its intended life; and
* are not otherwise included in rental fees or other charges for space.

**Disposition of Equipment**

*State and local governments*

Section 80.32(e) of EDGAR establishes specific rules for disposing of equipment, depending on what the equipment will be used for and the value of the equipment. When a grantee or subgrantee no longer needs equipment for the original program for which it was purchased, the grantee or subgrantee may use the equipment for other programs that are currently, or were previously, supported with federal funds. If such a disposition is made, the transfer must be recorded in the property management system.

If there are no federally supported programs that need the equipment, the disposal rules depend on the current fair market value of the equipment. If the equipment has a current fair market value of less than $5,000, the grantee or subgrantee may keep the equipment, sell it or otherwise dispose of it with no further obligation to ED. If the equipment has a current fair market value in excess of $5,000, the grantee or subgrantee may keep or sell the equipment but must pay ED a share based on the percentage of federal participation in the initial acquisition. (EDGAR does not address the scenario where equipment has a value of exactly $5,000.) It is important to note that grantees and sub grantees must follow their state or local thresholds if their thresholds for equipment are lower. ED’s share is calculated against the current fair market value if the grantee or subgrantee keeps the property or against the sale price if the grantee or subgrantee sells the property. For example, if a grantee purchased a copier with $5,000 of state funds and $5,000 of federal funds, the federal participation is 50 percent. If the grantee sells the copier for $6,000, the grantee must pay $3,000 to ED.

If the grantee or subgrantee is authorized or required to sell the property, proper sales procedures must be established to ensure the highest possible return.

Grantees and sub grantees must take care to accurately value equipment. Ensuring proper valuation is an important part of a sound control system.

The recipient must request disposition instructions from ED, if the recipient has no use for the equipment. The department then determines whether the equipment can be used to meet ED requirements. If no ED requirements exist, the equipment’s availability will be reported to the General Services Administration to determine whether a requirement for the equipment exists in other federal agencies. No later than 120 calendar days after the recipient’s request, ED will instruct the recipient what to do with the equipment.

If the recipient is directed to ship the equipment to another agency or IHE, it will be reimbursed for shipping and any interim storage costs, as well as proportionate share of the fair market value based on its original participation. If the IHE is instructed to dispose of equipment in another manner, it will also be reimbursed for its costs.

If disposition instructions are not issued within 120 calendar days, or if the recipient is so instructed, the IHE will sell the equipment and reimburse ED an amount based on the original federal participation in the costs. However, the recipient can deduct from the federal share $500 or 10 percent of the proceeds (whichever is less) for the recipient’s selling and handling expenses.

**Supplies**

Supplies are addressed in Section 80.33 of EDGAR for state and local government.

Supplies are any tangible personal property that is not considered equipment. Generally, supplies do not cost much money and are used fairly quickly because they are perishable items (e.g., pens, paper, and printer toner). As a result, supplies do not have to be recorded in an inventory management system and do not require a formal inventory every two years; however, grantees and sub grantees must maintain enough information about their purchases to prove all costs are necessary, reasonable and allocable, as required under OMB Circular A-87. This point is critical and discussed further in the section below.

If a grantee or subgrantee has unused supplies that, in the aggregate, have a fair market value of more than $5,000 at the end of grant award, the grantee or subgrantee should use the supplies for another project that is supported with federal funds. If the supplies are not needed for another federally supported project, the grantee or subgrantee must compensate ED for its share of the value of the supplies.

**Practical Advice Regarding Inventory Management for Items Purchased With Federal Funds**

As with financial management and procurement systems, the need to show compliance with fundamental cost principles shapes inventory systems.

On a practical level, it is easy to understand that if a recipient cannot find an item purchased with federal funds, cannot account for how an item purchased with federal funds was used, it becomes very difficult to prove that the expenditure on the item was necessary, reasonable, allocable and legal.

Therefore, when OIG auditors have focused on issues of inventory, it is not uncommon for them, in practice, to hold recipients of funds to a higher standard than the standards contained in EDGAR. In essence, all recipients of federal funds are well-advised to think about how they will track all “items” purchased with federal funds, especially technological merchandise that is often stolen or broken, regardless of value. In short, if a recipient cannot find items and explain how they were used to benefit the federal program (i.e., prove that the items were allocable to the federal program), the recipient risks an audit or monitoring finding.

**Maintain an Updated Inventory Management System to Locate Equipment Purchased With Federal Funds**

Many monitoring findings indicate that recipients could not locate equipment purchased with federal funds through their inventory management system. Accordingly, recipients of federal funds should ensure that their inventory records are up-to-date so that recipients can account for all items purchased with federal funds at any given time. When ED auditors or monitors conduct a site visit, they typically request a printout of the property records, which enables them to select specific items to locate and thereby test the accuracy of the property records. Accordingly, records need to be kept as up-to-date as possible.

**Ensure a System Is in Place to Track All Items Purchased With Federal Funds, Even Items Below the Formal Equipment Definition.**

Even though certain items may not cost enough to meet the formal threshold for the definition of equipment (such as laptops, which generally cost less than the equipment definition threshold), auditors and monitors want to ensure that these types of times are appropriately accounted for so that ED can analyze whether the expenditure was consistent with the cost principles. ED also is monitoring entities to ensure that they are exercising proper internal controls over all items purchased with federal funds.

Both the OIG and departmental risk managers have paid especially close attention to how grantees and sub grantees track items that are easily stolen or damaged, such as laptop computers, personal digital assistants (PDAs), printers and other relatively small technological devices. Most of these devices cost less than $5,000 per unit, so a formal inventory is not strictly required by EDGAR. However, through audits and monitoring reports, ED has suggested-and, on occasion, demanded – that some formal system of tracking these items be in place.

In fact, at one time, there were discussions within ED regarding the feasibility of regulations that would formally require recipients to account for “small and attractive items,” such as laptops, printers and PDAs, that cost less than the equipment threshold. ED has never developed regulations to that effect, and there remains no regulatory definition of small and attractive items. Still, it is important for grantees and sub grantees to be aware of the scrutiny that OIG and other ED staff have afforded to these items.

**Adequate Sign-Out Procedures for Items That Are Portable**

Several monitoring reports had findings that entities did not have adequate control procedures in place for items that could be “checked out” and used off-site, such as laptop computers. As a corrective action, ED has demanded that these entities develop policies requiring items that are purchased with federal funds and taken away from their assigned location be subject to formal “check out” procedures. These “check out procedures” ensure that the person checking out the item is accountable for its proper custody.

**Adequate Tagging of Items**

Recent monitoring reports also contain findings regarding the insufficient tagging of items because the items either were not tagged or were tagged in a manner where the identification could be easily removed. As a corrective action, ED required entities to ensure that items are tagged in a manner that identifies the equipment and that the tags cannot be easily removed.

**Audit Tips**

* Be sure that any equipment purchased with federal grant funds is being used to benefit the program that provides the funding in accordance with the relative benefit received. For example, if the Migrant Education program paid 100 percent of the cost of computers, then the computers must be used exclusively to benefit the Migrant Education program. This has been a common finding in federal monitoring reviews by ED.
* Taking routine physical inventories and comparing the results to property records is a sound internal control. But it is not sufficient to conduct an inventory and then put the list away until the next time. Your inventory list should be continuously updated to reflect any change in the location or status of an item, so the item can be located on demand.
* It is a good idea for grantees and sub grantees to:
* maintain written procedures explaining how they value equipment;
* ensure employees are trained on these procedures; and
* maintain sufficient documentation to support a valuation.

Referenced from: Federal Education Grants Management: What Administrators Need to Know, 3rd Edition, Thompson Publishing