



AND



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COST ALLOCATION

Red Flags and Remedies



Community Action Partnership

September, 2012

COST ALLOCATION: Red Flags and Remedies

Community Action Partnership

The Community Action Partnership is the nonprofit, national membership organization representing the interests of the 1,000+ Community Action Agencies (CAAs) across the country that annually help 17 million low-income Americans achieve economic security. Whether it's a Head Start program, weatherization, job training, housing, food bank, energy assistance, financial education, or any of the other 40-plus distinct programs, CAAs work to make America a better place to live.

CAPLAW

CAPLAW is a 501(c)(3) nonprofit membership organization, established in 1989, dedicated to providing the legal, governance and management resources necessary to sustain and strengthen the national Community Action Agency (CAA) network. For nearly 50 years, since the Economic Opportunity Act of 1964 established the Community Action Program, CAAs have been working to strengthen low-income communities and to help low-income individuals and families achieve self-sufficiency and economic security.

Through its in-house staff and a network of private attorneys, CAPLAW provides consultation, training, and resources on a wide variety of legal, governance and management topics. This assistance enables CAAs to operate legally sound and well-governed organizations, thereby enhancing their ability to effect positive change in their communities.

Kay Sohl

Kay Sohl brings over 30 years successful experience providing consulting, training, and facilitation for nonprofit organizations, governmental entities, and corporate community engagement programs. Her expertise includes: nonprofit financial management; federal funds compliance issues; strategic planning; board development; feasibility studies and business plan development; nonprofit sustainability strategies; organizational assessment and capacity building; strategies; collaborations, mergers, and spin-offs; evaluation and accountability strategies; tax exempt status and IRS compliance issues.

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This Toolkit was created as a collaboration between The Community Action Partnership and CAPLAW.

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Introduction to the Toolkit

This toolkit is designed to help your Community Action Agency (CAA) meet the requirements for cost allocation contained in Office of Management and Budget A-122 (OMB Circular A-122, now incorporated into the Code of Federal Regulations as 2 CFR Part 230).

Problems with cost allocation are among the most common audit and funding source monitor findings. In order to substantiate charges to federal, state, and local grants and contracts, CAAs must develop and implement effective approaches to cost allocation. At a deeper level, every CAA needs a sound cost allocation system in order to understand what it really costs to deliver their services. Sound cost allocation is required for GAAP accounting and for correct completion of the IRS Form 990.

The term cost allocation is used to describe the method your CAA uses to determine and document the connection between the costs your organization incurs and the programs or services which you provide. While the relationship between costs incurred and specific programs is extremely clear for costs that benefit only one program activity, other costs – typically facilities and administrative costs – provide benefit to multiple programs or activities. Your approach to cost allocation will determine how you divide up these shared costs (such as facilities, telephone, administration and many others) to reflect the benefit each program or activity receives.

Nonprofit organizations that receive federal grant funds - either directly from federal agencies (support of programs such as Head Start) or more commonly passed through state and/or local governments (such as CSBG) - must meet OMB Circular A-122's cost allocation requirements. Those nonprofits that receive grant funds directly from federal agencies may choose to, or be required to, obtain a Federally Negotiated Indirect Cost Rate (NICR) which is based on the ratio between their total indirect costs and an equitable direct cost base. CAAs that do not have direct federal awards, have chosen not to obtain an NICR, or have an NICR but have additional shared costs that are not included in the indirect cost pool, must rely on a cost allocation plan in order to justify charging shared costs not included in their NICR to grants or contracts that involve federal funds.

This Toolkit is designed primarily for CAAs that do not have Federally Negotiated Indirect Cost Rates, or that charge some shared costs outside of the Indirect Cost Rate. The Toolkit also includes a discussion of the pros and cons of obtaining an NICR for those CAAs that are free to make that choice. Of course some CAAs do not have a choice because they are unable to obtain an NICR because they do not receive federal grant funds directly from federal agencies.

Cost Allocation Red Flags

Use this quick check-up tool to identify warning signs that your current approaches to cost allocation may put you at risk for compliance issues and potential audit findings.

- 1** | Your CAA does not prepare a comprehensive annual budget which includes all sources of funds and all costs which will be incurred during your fiscal year and allocates costs that benefit more than one program or cost center in ways that are consistent with your cost allocation plan.
- 2** | You have some contracts/grants that do not include funding for some or all of your administrative and/or shared costs and have not identified the funding sources that will be used to cover these costs.
- 3** | You deal with the problem of having some contracts/grants that do not include funding for some or all of their fair share of administrative or other shared costs by shifting the costs that those funders will not cover to other cost centers with funders that do not impose such severe limits.
- 4** | You do not have a written cost allocation plan.
- 5** | You have a written cost allocation plan but are unclear about whether you need to have it approved by your funding sources or how to obtain their approval.
- 6** | You have a written cost allocation plan but you do not review and revise it annually.
- 7** | You do not have a system for testing whether you are following your cost allocation plan throughout your fiscal year.
- 8** | Your cost allocation plan calls for allocating certain costs based on the percentage of FTE (full time equivalent positions) in the *budget* of each cost center rather than the percentage of staff time *actually* devoted to each cost center as documented by contemporaneously maintained personnel activity reports.
- 9** | Your cost allocation plan calls for allocating certain costs based on the percentage of program dollars in each cost center *budget*.
- 10** | You do not re-examine your cost allocation plan and allocation percentages each time you have substantial increases or decreases in specific grant/contract funding levels or add or drop grants/contracts or programs.

Look for “red flag fixes” throughout the guide for discussion relating to each of the red flags above.

Why CAAs Allocate Costs

CAAs operate in a funding environment in which most of their awards and contracts provide income on a cost recovery basis. Whether a funding agreement is characterized as a grant or a contract, most agreements specify costs for which the funds may and may not be used. Within the limits of the specific agreement, the CAA is entitled to receive funds for allowable costs incurred. The process of documenting allowable costs that have been incurred and justifying the use of funder dollars to meet those costs is referred to as cost recovery.

Under such agreements, the CAA must be able to prove that it has incurred a cost that is allowable. Proving that you have incurred a cost is the easy part; good documentation is key. Proving that the cost you incurred is allowable may be relatively easy when the entire cost is directly related to the programmatic goals embodied in a specific funding agreement.

Example: Best CAA employs a Head Start Teacher who teaches in a Head Start classroom. The cost of employing the Head Teacher is directly related to achieving the goals of Best CAA's Head Start award.

But some costs are related to delivery of multiple services funded through multiple funding agreements. Costs such as rent for a facility housing multiple programs, a telephone system serving multiple programs, or costs associated with financial management or Board support, are referred to by many names including shared costs, indirect costs, and overhead costs.¹ This guide uses the term “**shared costs**” to describe costs that provide benefit to more than one program or service activity (and will have to be recovered from more than one funding agreement).

To determine what portion of such shared costs may be charged to or recoverable from each of those multiple funding agreements, your CAA will have to allocate costs. In other words, you will have to figure out a defensible way to estimate the benefit that each of your distinct program activities or funding source agreements received from the shared costs you incur.

¹ Most federal agencies will not pay a grantee for a cost called an “indirect cost” unless the grantee has a Federal Negotiated Indirect Cost Rate. Therefore, for grantees that do not have an NICR, or are charging a cost outside of the NICR, a shared cost that will be charged to a federal grant must be allocated and charged as a direct cost, assuming there is a reasonable method of allocation.

A-122 Requires Cost Allocation

Recipients of federal funds such as CSBG and Head Start are required to comply with the federal cost principles for nonprofit grantees contained in the Office of Management and Budget Circular A-122 which is now published in the Code of Federal Regulations as 2 C.F.R. Part 230. Appendix A of the circular requires that for a cost to be an allowable use of federal funds (i.e. reimbursable with federal funds), the cost must be reasonable, **allocable**, adequately documented, calculated in accord with GAAP (see below), and conform to specific limitations about types of costs contained in Appendix B of the Circular. This toolkit focuses on methods, policies, procedures, and systems which your CAA will need to put in place to be sure that the costs you charge to your grants and contracts meet the A-122 requirements to be “**allocable**”.

Generally Accepted Accounting Principles (GAAP) Requires Cost Allocation

Recipients of federal funds are required to maintain financial records using methods that are consistent with Generally Accepted Accounting Principles (GAAP), the standards used by Certified Public Accountants (CPAs) to determine what comprises a fair presentation of an organization’s financial position and activity. GAAP requires nonprofit organizations like CAAs to present financial information about their expenses in a matrix format which describes both the line-item character of the expense (like salaries, telephone, etc.) and the purpose or function for which the expense was incurred. In terms of purposes or functions, GAAP specifically requires that nonprofits distinguish between expenses incurred for program purposes and those incurred for management or fundraising purposes. (ASC 958-720-45-2) Within the broad category “program,” nonprofits may present additional distinctions, such as characterizing a portion of their program expenses as being for Early Childhood Education, Homeless Services, Energy Assistance, etc.

Figure 1. GAAP Matrix

	Total	Management	Fundraising	ECE	Homeless Services	Energy Assistance
Personnel						
Prof. Services						
Occupancy						
Total Expenses						

Recognizing that some costs are incurred to provide benefit to multiple functions (management, fundraising, and multiple programs), GAAP requires that nonprofits allocate shared costs in a logical and consistent manner which reflects the relative benefit a cost provides to each distinct function.

IRS Form 990 Requires Cost Allocation

Nonprofit CAAs are required to file the Form 990 Annual Information Return with the IRS. The IRS requires presentation of expense information in much the same matrix format as GAAP, distinguishing expenses for management, fundraising, and program purposes. Shared costs must be allocated to reflect the relative benefit provided to each of these functions.

Sound Business Planning and Management Requires Cost Allocation

Sound business planning requires that nonprofits know the full cost of delivering each service they provide. CAAs that are considering increasing their earned income or developing social enterprise initiatives must have accurate information about the full cost of delivering services in order to set prices and determine whether earned income strategies are adding to or taking away from overall financial health. Cost allocation is an essential element in determining the full cost of each service the CAA provides. The core principle embodied in A-122 is that only costs that are necessary to achieving the goals of a grant or contract may be charged to and recoverable from that award. CAAs must be able to document the relationship between a specific cost and achievement of those goals. When costs are incurred that provide benefit to multiple activities or awards, A-122 requires using a systematic approach to estimate the relative benefit received by each activity or award.

Cost Objectives/Cost Centers

To comply with A-122, each CAA must establish a cost center structure to use for budgeting, accounting, and reporting purposes. A-122 uses the term *Cost Objective* to describe a grouping of costs related to achieving a specific purpose. It may be helpful to think of cost objectives as being a series of buckets that your CAA will use to sort out its different activities. In accounting and budgeting terminology, we'll refer to these buckets as cost centers.

There are many different ways you could organize your approach to setting up your buckets/cost centers. One way would be to use a different cost center for each funding source. Another way would be to use a different cost center for each major type of program service and separate cost centers for management and fundraising. In this second approach, you might have several different funding sources contributing the resources needed to support the costs associated with one program cost center. For example, you might have a homeless services bucket that included grants from your city, your state, and some direct federal awards, all of which were intended to support services for homeless families. In this approach, you would need to track the use of each distinct funding source but from the viewpoint of compliance with A-122; the overall program bucket/cost center “homeless services” would be the cost objective. This approach can really help resolve some of the problems caused by funder limitations on administrative costs – see section on [Dealing with Limits on Indirect Costs](#) for more details.



Red Flag Fix

Only a comprehensive budget showing all sources and uses of funds can demonstrate your plan to allocate costs fairly among all cost objectives/cost centers that benefit from them.

Direct Costs

A-122 is built on the core concept that all costs needed to carry out a federally-funded activity can be characterized as being associated with a cost objective/cost center either directly or indirectly. Costs that are directly related are those that are incurred solely for the purpose of one cost objective/cost center – as in the earlier example, the cost of employing a teacher in a Head Start classroom is a direct cost of the Head Start cost center. A-122 requires that CAAs document the relationship between direct costs and the accomplishment of grant/contract objectives. The Personnel Activity Reports (PARs) Toolkit, found on the Community Action Partnership’s website at www.communityactionpartnership.com, provides in-depth discussion of the type of documentation that is needed to establish the direct relationship between an employee’s work and the accomplishment of the goals of a specific award.

Shared or Allocated Costs

A-122 recognizes that some costs that are essential to achieving the objectives of your funding awards do not have an easily observable direct relationship to specific cost objective/cost centers.

Example: Best CAA operates a Head Start program. Some of the Head Start classrooms are located in a building that includes facilities for other program activities and for management and fundraising activities. The CAA pays the landlord \$10,000 per month for the entire building. In order to establish a direct relationship of the rent expense to the Head Start cost center, the CAA would need to negotiate a separate lease with the landlord for each program, management, or fundraising function housed in the facility. While this would result in documentation of the direct relationship between the rent and the Head Start cost center, it would be inefficient and impractical. In order to avoid this inefficient approach, Best CAA has developed and implemented a cost allocation plan which documents the relationship between the rent charged to the Head Start award and percentage of the space in the shared facility that is utilized by the Head Start program.

A-122 recognizes that it will be more efficient to establish the relationship between a shared cost such as rent and a cost objective/cost center such as Head Start by estimating the relative benefit provided to Head Start that results from the expense of rent for the whole facility.

Similarly, a receptionist who directs calls to multiple programs and administrative and fundraising staff provides benefit to all of those functions. A-122 defines multiple allowable methods to estimate the relative benefit of shared costs to various cost objective/cost centers and also prohibits use of the “availability of funds” cost allocation method.

Documenting the Relationship Between Costs Incurred and

Cost Objectives/Cost Centers

A-122 requires that recipients of federal funds document the relationship between costs incurred and specific cost objectives/cost centers in order to justify charging the costs to the federal awards related to each cost objective/cost center. The relationship of direct costs is documented through straightforward analysis and appropriate approval by managers with knowledge of the use of the items purchased or staff positions identified as direct costs. The PARs Toolkit provides guidance on documenting the relationship between the costs of employing staff and the achievement of award objectives. Documenting the relationship between shared costs and specific cost objectives/cost centers requires establishing and consistently implementing a cost allocation plan. A-122 requirements for cost allocation plans are discussed below. See FASAB Handbook, Version 10, Page 43, paragraph 24. Cost Allocation Methods- 3 Key A-122 Criteria.

A-122 permits recipients of federal funds to define the methods they will use to allocate shared costs. It recognizes that many recipients will choose to use several different methods to allocate different types of costs (for example, one method to allocate the cost of shared facilities and a different method to allocate the cost of the receptionist whose work provides benefit to multiple cost centers).

Reasonable Estimate of Benefit Received

A-122 specifies that in order to substantiate charging a portion of a shared cost to a specific award, the CAA must use an allocation method which provides a **reasonable estimate** of the benefit which is received by each cost center from the expenditure of funds on a shared cost.

8

Red Flag Fix

Allocation must be based on actual costs incurred, not budgeted or planned costs.

4

Red Flag Fix

Your cost allocation plan must be comprehensive including fair allocations to all cost objectives, even those in which funders impose limitations on the use of their funds. Your plan allows you to demonstrate that you are fairly allocating costs in relation to the benefit provide to each cost objective.

Example: In order to justify charging a portion of the cost of renting a facility which houses multiple programs and functions to a specific federal award (as described in the example above), Best CAA must demonstrate that the method of allocating the facility rental costs provides a reasonable estimate of the benefit received. Best CAA estimates the benefit received by each cost center by determining what portion of the total rented facility is used to house staff and conduct program efforts for each program. Best analyzes the total use of space in the facility and determines which portions of the space are used to house specific staff and activities and which portions are common spaces, such as rest rooms and reception areas. Best estimates the benefit received by each program through calculating the percentage of space utilized by staff and activities of each program.

Some staff housed in the facility perform work that benefits multiple programs or is supported through multiple funding sources. Best CAA utilizes employee Personnel Activity Reports (PARs) to determine the actual use of staff time and effort, and establish the portion each position which benefits each cost center/cost objective. The actual use of staff time becomes the basis for calculating the square feet utilized by each cost center which is the basis for allocating the space costs.

Consistent Application of the Cost Allocation Method

Charging an allocated portion of a shared cost to a specific award also requires that the recipient apply its allocation methods consistently. While it is permissible to use various allocation methods to allocate various different types of costs, the method used for any one type of cost must be used consistently.

Allocation Methods Must Not Be Unreasonably Costly to Apply

One final general criterion must be applied in considering whether a cost allocation method will be allowable under A-122. The method must not be unreasonably costly to apply. For example, while it would be possible to estimate the benefit provided to each cost center by the purchase of a ream of copier paper by having a clerk keep track of the purpose for which each piece of paper is utilized, this would be an unreasonably costly method in that it requires investment in costly staff time to gain greater precision about a relatively small cost item.

Common Allowable Cost Allocation Methods

Percentage of Actual FTE Utilized

Many CAAs make extensive use of a cost allocation method based on the percentage of total staff time which is devoted to each cost objective/cost center. In order to charge all or a portion of the cost of employing a staff person to a specific award, the CAA must maintain documentation that demonstrates that the employee performed work that benefited that award. The PARs toolkit provides in-depth discussion of the requirements for maintaining this documentation. In addition to meeting the basic requirement for charging staff time to awards, the properly maintained Personnel Activity Report documentation may be used to create an agency-wide allocation formula which estimates the benefit provided by shared costs to all cost centers. The use of estimates of benefit based on percentage of total actual FTEs associated with various costs centers relies upon the assumption that there is a relationship between the amount of staff time invested in performing an activity and the share of benefit received from a shared cost.

8

Red Flag Fix

Allocation must be based on actual work performed and documented through Personnel Activity Reports.

Some CAAs combine the information on the use of time from all employees to create an allocation formula to estimate the relative benefit which each cost center receives from certain shared costs (such as telephone, reception) that benefit all cost centers. The rationale for this approach is the assumption that the number of FTE (full time equivalent) positions working to benefit a specific cost center is the primary driver for the benefit received by that cost center from shared costs.

Example: Best CAA requires employees to complete Personnel Activity Reports as described in the PARs Toolkit. At the end of a pay period, Best determines that the work of 2 FTE positions has been devoted to Program A, while the work of 4 FTE positions has been devoted to Program B. Consequently, Best estimates that Program B has received twice as much benefit from use of the telephone system or reception function as Programs A, and that Program B should receive twice as large a share of the cost of the telephone system and reception function.

CAAs using percentage of FTE as an allocation method must pay special attention to the records they maintain of employee activity. The Personnel Activity Report (PAR) Toolkit provides essential guidance on tracking the use of employee time and effort. A critical starting point for understanding the federal requirements in this area is to remember that A-122 requires recipients to maintain records of the actual use of employee time. Cost allocation approaches which create an allocation formula based on the planned use of staff time (i.e. budgeted FTE) are not allowable.

Percentage of Space Utilized

The percentage of total space utilized is a common allowable method for allocating costs associated with facilities (rent, utilities, janitorial service, etc.). In this method, a formula is created by determining what percentage of the space in a facility housing multiple programs and functions is utilized by each program or function. Typically, the recipient maps out the use of space by each program/function on a floor plan of the entire shared facility. Common spaces such as restrooms, meeting rooms, and shared reception areas are also measured. The percentage of the assigned space (the total space less the common spaces) which is utilized by each program/cost center is calculated and used to allocate the total facilities costs.

Similar to the method described above, this method requires basing the formula on the *actual* use of the space, not a budgeted or planned use. This can be an important distinction for recipients who experience major shifts in how space is used during the year, for example, mid-year growth in a specific program or mid-year contraction.

For example, when Best CAA developed its annual budget it projected that 25% of the space in its building would be utilized by staff working on Program A. Best used a two-step process to calculate the percentage of space actualized utilized by Program A. The first step involved using staff Personnel Activity Reports to determine how many employees devoted all of their efforts to Program A. The space utilized by these employees was then included in the square footage allocation formulas. Next, Best reviewed the PARs completed by employees who reported working to benefit multiple programs or functions. Best used this information to determine the portion of space utilized by each employee which should be included in the calculation of the space used by each program/cost center. Best used this information to determine the portion of the total space used by each program and allocated the costs of the space according to the percentage of space actually used.

Percentage of Units of Service

In some situations it may be possible to allocate some shared costs based on the number of units of service delivered by each program/cost center.

Example: Best CAA operates a call center that provides information and help relating to the various programs that Best operates. Best tracks the number of calls that call center handles about each of its programs each month, and then calculate the percentage of all calls that were handled for a specific program/cost center. Best uses this percentage of units of service delivered to allocate the labor and other costs of operating the call center, because it is a reasonable way to estimate the benefit received by each program.

Figure 2 – Percentage of Calls

Call Subject	# of Calls	% of Calls
Program A	100	10%
Program B	200	20%
Program C	50	5%
Program D	350	35%
Program E	200	20%
Management	100	10%
Total Calls	1000	100%

Like all the other methods described above, this method requires tracking the *actual* number of units of service rather than allocating based on budgeted or planned percentages. For some recipients this method is problematic because the nature of the services provided in their various programs is quite different, with services in some programs being delivered in less than an hour and services delivered in other programs requiring several days. In this situation, the percentage of total units of service would not be a reasonable basis for estimating the benefit received from shared costs.

Methods That May or May Not Be Allowable

A-122 includes a description of specific methods for allocating shared costs that are permitted to be used as the basis for negotiating federal indirect cost rates. These methods involve creating formulas based on either the percentage of direct expenses recorded in each cost center or percentage of salaries or of total compensation recorded in each cost center. Some experts interpret A-122 to allow the use of these methods only when they are used as steps to calculate a negotiated indirect cost rate. In their view, shared costs allocated using a method based on the percentage of dollars expended in various cost centers (either direct expenses or compensation expenses) are only allowable for organizations which have obtained an approved indirect cost rate. From this point of view, these methods should not be used to allocate costs by organizations without a negotiated indirect rate.

However, some states and local jurisdictions that enter into contracts to provide federal funds to nonprofits (for example, CSBG) require or allow the use of allocation methods that are based on the percentage of expenses (either total direct expenses or compensation expenses) which are incurred in each cost center.

In essence, those jurisdictions permit an indirect cost rate, although not necessarily one approved by the federal government.

Unless your CAA is required or permitted by contract to use one of the percentage of expenses methods for allocating shared costs, it is probably safer to utilize one of the other allowable methods to estimate the benefit received by various cost centers from shared costs.



Red Flag Fix

Allocating costs based on the percentage of program dollars in each cost center budget results in two different problems. First, all allocations must be based on costs incurred rather than budgeted costs. Beyond this, many auditors interpret A-122 to allow the use of the percentage of dollars incurred in each cost center as the basis for allocating administrative costs only for organizations with NICRs. Read this section to understand the differing opinions on this issue but remember, the starting point is always that you must base allocations on costs actually incurred, not budgeted costs.

Unallowable Cost Allocation Method – Availability of Funds

A-122 specifically forbids the use of an allocation method that is based on the availability of funds. In this method, the basis for charging a shared cost to a specific program/cost center is the availability of funds from a particular funding source to cover that cost. Unfortunately, some recipients slip into using this unallowable method inadvertently when they prepare budgets for their grants and contracts on a piecemeal basis and fail to develop a comprehensive annual budget plan which includes all sources and uses of funds.

Another common cause of using this unallowable method arises when specific funding sources place limits on the amount of dollars or percentage of funds which may be spent on specific line items, most commonly on administrative costs. To meet the requirements of A-122, allocated costs may only be charged to specific awards when the recipient has established a cost allocation method which is based on a reasonable estimate of the benefit provided to each cost center, not a method which is based on the availability or lack of availability of funds from specific sources to cover allocated costs.



Red Flag Fix

Failing to demonstrate the unrestricted sources you are using to cover the fair share of an allocated cost which exceeds a limit set by a restricted funder results in using the unallowable method of basing allocation on the availability of funds.

Example: Foggy CAA had several awards that placed limitations on the amount of administrative costs that could be charged to the award. Foggy charged only the allowable amount of administrative costs to these awards and then divided the remaining administrative costs among programs funded by awards that did not impose specific limitations on the amount of administrative costs which could be charged. Foggy believed that because the other funding sources had approved budgets for their awards that were based on this approach to allocation, that the allocation method had been approved. Unfortunately, Foggy's auditor determined that this practice was in violation of A-122, Appendix A, Section A.4 which states that "any cost allocable to a particular award or other cost objective... may not be shifted to other Federal awards to overcome funding deficiencies or to avoid restrictions imposed by law or by the terms of the award."

Relationship Between Unallowable Costs and Cost Allocation

A-122 Appendix B describes certain types of costs such as lobbying (Appendix B Section 17) and fundraising (Appendix B Section 25) as unallowable for purpose of the use of federal funds. CAAs should establish separate cost centers for functions such as lobbying and fundraising to capture costs which must not be charged to federal awards. Appendix A, General Principles, (Section B. 4) explicitly requires that all cost centers that receive benefit from a shared cost be charged with a fair share of that cost. If lobbying or fundraising activities are carried out by staff housed in a common facility, the lobbying and fundraising cost centers must receive a fair share of the allocated costs for the facility. Similarly, if the Executive Director or other staff spend time performing lobbying or fundraising functions, their Personnel Activity Reports must be utilized to determine what portion

of the cost of their employment must be allocated to these functions. If your plan for allocating shared administrative costs is based on the percentage of FTE devoted to the activities of each cost center, the activity devoted to fundraising and lobbying must be included in the calculation and a share of administrative costs must be allocated to the lobbying and fundraising functions. This same principle should be applied to any other functions which may be deemed unallowable through A-122 or specific funding agreements.

Federally Negotiated Indirect Cost Rates

What is a Federally Negotiated Indirect Cost Rate?

A Federally Negotiated Indirect Cost Rate (NICR) is an agreement between a federal agency and a nonprofit federal grantee which establishes the maximum amount of indirect costs that the nonprofit may claim in its federal awards by calculating the organization's indirect costs as a percentage of direct costs. In order to obtain an NICR, the nonprofit organization must have a direct funding relationship with a federal agency. Nonprofits seeking NICRs must determine which of their federal funding sources will serve as their cognizant agency and follow the procedures of the Division of Cost Allocation of that agency.

A-122 Appendix A describes the information which must be included in the nonprofit's proposal for an indirect cost rate. Once the proposal is submitted, the Division of Cost Allocation assigns a negotiating officer to work through questions, request modifications of the proposal, and ultimately issue a written acknowledgement of the agreed upon indirect cost rate.

A-122 permits multiple approaches to determining indirect cost rates and also describes four distinct types of NICR which may be approved by federal agencies. Because this Toolkit is designed for CAAs that do not have an NICR, or have an NICR but also allocate some shared costs that are not in the indirect cost pool, it does not include details on the permissible methods and types. Consult A-122 Appendix A for more information in these areas.

Can Our CAA Obtain a Federally Negotiated Indirect Cost Rate?

Your Community Action Agency may find itself in one of three positions in regard to obtaining a negotiated indirect cost rate. Some CAAs are required to negotiate an indirect rate if they want to recover any management costs which cannot be directly associated with specific cost centers, others are permitted to negotiate an indirect cost rate, and still others are not able to negotiate an indirect rate.

Only recipients of direct federal awards may obtain an NICR. CAAs that receive federal funds solely through contracts with state or local governments or other nonprofits and have no direct federal awards cannot obtain a negotiated indirect cost rate. CAAs that have Head Start awards or other

direct federal awards may or may not be required to obtain a federally negotiated indirect cost rate by their funders.

Impact of Not Having a Federally Negotiated Indirect Cost Rate

Only organizations with a Federally Negotiated Indirect Cost Rates are permitted to report costs on the Indirect Cost line on reports on the use of federal funds (SF-425). While organizations without a negotiated indirect cost rate are able to recover shared costs as well as direct costs from their federal awards, they may not claim these costs under the heading “indirect costs”. See the discussion of Cost Allocation Plans below for a description of the methods that organizations without NICR use to recover shared costs, including administrative costs.

Cost Allocation Plans for Organizations Without a Federally Negotiated Indirect Cost Rate

What is a Cost Allocation Plan?

A cost allocation plan is a written document which describes the methods that the CAA will use to charge both direct and shared costs to various programs/cost centers. It is virtually impossible to meet the requirements for cost allocation contained in A-122 without adopting and consistently implementing a written cost allocation plan. A compliant cost allocation plan describes how the CAA will handle both direct and shared or indirect costs. Appendix 4 to this Toolkit provides step by step guidance to developing a Cost Allocation Plan.



Red Flag Fix

The lack of a cost allocation plan can be a serious indicator of trouble to come. Start here to learn more about a creating a cost allocation plan.

This Toolkit focuses on the treatment of shared costs. A-122 contains additional requirements for documenting the relationship between specific direct costs and the cost centers to which they are charged. It is the treatment of the shared, those costs which provide benefit to more than one cost center, that is the central focus of the cost allocation plan.

Obtaining Approval of Your Cost Allocation Plan

State and local funding sources take widely differing approaches to approving CAA cost allocation plans. Some funding sources require that all funding recipients submit a Cost Allocation Plan for approval and also require approval for any modifications to the plan.

Other funding sources review CAA Cost Allocation Plans as part of the monitoring process. While these funders do not have a process for approving proposed plans, they may include concerns and criticisms of the organization's cost allocation plan in exit interviews or in monitoring reports. Still other funding sources prepare formal findings when monitors conclude that a CAA's cost allocation plan does not comply with A-122, or the requirements of specific federal or state contracts. A few states take the position that they will not approve the charging of any allocated costs (including administrative costs) to their awards unless the recipient has a federally negotiated indirect cost rate.

5

Red Flag Fix

Obtaining approval for your cost allocation plan can be difficult. This section addresses the challenges one may encounter.

Auditors performing A-133 audits for organizations receiving federal funds are required to determine whether the organization has achieved substantial compliance with A-122, including compliance with requirements for allocating costs. If your auditor finds significant deficiencies or material weaknesses either in the cost allocation plan itself or in your implementation of the plan, these items will be reported as findings in your A-133 audit. Your CAA will be required to describe how you will correct the deficiencies or weaknesses, and then implement your plan for correction in subsequent years.

Most CAAs find it helpful to discuss their cost allocation plan with their independent auditor prior to undergoing an audit. While auditors cannot take on the management function of deciding how your CAA will allocate costs or authoring your cost allocation plan without compromising their independence, many auditors are willing to discuss client cost allocation plans to identify potential problem areas.

Why Every CAA Must Have a Cost Allocation Plan

It is virtually impossible to meet the requirements of A-122 without having a comprehensive written cost allocation plan. The plan is an essential tool for financial planning, accounting, and reporting. For CAAs that are unable to seek a negotiated indirect cost rate, choose not to negotiate one, or choose not to include all shared costs in the negotiated indirect rate, a written cost allocation plan is an essential tool for achieving and documenting compliance with the requirements of A-122 and substantiating charges to federal awards for allocated costs.

CAAs seeking federally negotiated indirect cost rates must make a series of choices about which costs they will include in the category of "indirect" costs and a second set of choices about how they will calculate indirect costs as a percentage of direct costs. Of course all of these choices are limited by detailed guidelines provided in A-122. In almost all cases, the CAA will have some shared costs which are not included in their indirect cost rate and consequently will need to develop a written cost allocation plan to document how they will allocate the remaining shared costs. Consistent use of their cost allocation plan will result in being able to charge a properly allocated portion of the shared costs that are not included in their indirect cost rate as direct costs.

Beyond meeting the requirements for managing federal funds, a cost allocation plan provides information that is extremely helpful for preparation of proposals for private funding and for fully understanding your business model, especially if your CAA operates some programs on a fee for service basis. The cost allocation plan also plays a critical role in your overall accounting process by

providing consistent guidance on the allocation of shared costs among your various programs/cost centers.

Administrative Costs

A-122 Treatment of Administrative Costs

A-122 defines administrative costs as the costs of “general administration and general expenses such as the director's office, accounting, personnel, library expenses and all other types of expenditures not listed specifically under one of the subcategories of facilities” (Appendix A to Part 230 General Principles Section 3 (C)(3)).

While A-122's definition of administrative costs is relatively easy to understand, the guidance the Circular provides for recovering administrative costs from federal awards is one of the greatest sources of confusion and controversy. The underlying challenge lies in the reality that while specific cost items can be directly associated with the function of administration – for example, the cost of performing accounting for the organization – most administrative costs function as shared costs in that performance of administration functions benefits multiple cost objectives/cost centers.

CAAs with federally negotiated indirect cost rates recover their administrative costs by including them in their indirect cost rates and charging the approved rate as a percentage of the direct costs (either the entire direct cost, or the cost of compensation) of each cost objective/cost center, characterizing these costs as “indirect costs” for reporting purposes. CAAs without negotiated indirect cost rates cannot report or recover any costs from a direct federal grant through charges to the “indirect cost” line item on Federal Financial Report Form 425 (Line 11).

So how do CAAs without negotiated indirect cost rates recover administrative costs? CAAs without indirect cost rates must identify and justify the method or methods that they will use to estimate the benefit provided by administrative costs to specific award cost objectives/cost centers. Some organizations utilize an administrative cost pool approach through which administrative costs are first recorded in an administrative cost center and then the total costs of the administrative cost center are allocated through use of an estimating method. Other organizations prefer to allocate specific administrative cost items - for example, the cost of the annual audit - on a transaction by transaction basis, using an appropriate allocation method to estimate the benefit provided by each individual administrative cost item to each cost objective/cost center.

Figure 3 – Cost Pool vs. Transactional Allocation

Method 1				
Allocation of Admin Cost Center Total				
		Program A	Program B	Program C
Allocating %		50%	30%	20%
	Admin Costs			
Audit Cost	16,000			
Board Consultant	4,000			
Accounting Consultant	5,000			
Total	25,000	12,500	7,500	5,000
Method 2				
Allocation on Transaction by Transaction Basis				
		Program A	Program B	Program C
Allocating %		50%	30%	20%
Audit Cost	16,000	8,000	4,800	3,200
Board Consultant	4,000	2,000	1,200	800
Accounting Consultant	5,000	2,500	1,500	1,000
Total	25,000	12,500	7,500	5,000

Of course, in either method, the CAA must have a justification for the allocation of administrative costs to the various programs. All three of the cost items included in this example provide benefit to the entire organization (assuming that the accounting consultant provided services to improve the overall accounting process rather than resolve problems relating to one or more specific programs).

CAAs with an NICR would include all three costs in their indirect rate. CAAs without an NICR must describe a fair method of determining the benefit that such administrative costs provide to each cost objective/cost center. One common method would be to use the actual percentages of FTE effort devoted to each cost center to create a formula to allocate such costs. The example above would reflect a month in which analysis of the PARs for all staff demonstrated that 50% of all FTE position efforts (other than positions devoted to administrative functions) were devoted to Program A, 30% to Program B, and 20% to Program C. Use of the percentage of FTE method could be justified by the assumption that programs utilizing a greater percentage of personnel time received a greater benefit from having an effective board, effective accounting system, and annual audit.

In both the pooled approach and the transaction by transaction methods, the result is adding a prorated share of the administrative cost to each cost objective/cost center. If the administrative cost is incurred for the compensation of employees performing administrative functions, the

allocated cost would be added to the personnel cost line item on federal funds reports. If the cost is incurred for an administrative purpose - such as professional service fees - the prorated share would be added to a professional services line item of the benefiting cost objectives/cost centers. Thus the allocated share of administrative costs which have been estimated as the benefit received by a specific program/cost center will be reported on the appropriate “direct cost” line items on the SR-425 and other reports.

There are several different interpretations of the requirements of A-122 for allocating and reporting administrative costs. Some auditors interpret A-122 to permit utilizing a formula based on the percentage of FTEs attributed to each cost objective/cost center (based on PARs), with the formula being applied either to the total administrative expenses or to each administrative cost transaction.

Other auditors interpret A-122 to require the use of substantially more specific methods to justify the charging of most administrative costs to awards/cost objectives/cost centers. For example, they would recommend allocating the cost of the accounts payable function (i.e. the staff performing that function and related costs, such as space) by determining the percentage of all payments processed that resulted from direct expenses charged to specific cost centers; or they may recommend charging human resource administrative functions based on a formula derived from the number of employees recording time devoted to each cost objective/cost center. This more specific approach becomes very challenging in relation to allocating the cost of the Executive Director/CEO. While some auditors interpret A-122 to allow the use of estimating formulas based on actual use of staff time attributed to the various cost objectives/cost centers within the organization to charge for time that is not spent on just one particular grant (for example review of the updated Personnel Policies), others believe that charges for Executive Director costs may only be justified through analysis of the actual use of the Executive Director’s time. The latter approach would not permit direct charging to grants (at least those to which A-122 applied) time that was spent on activities that benefitted the agency as a whole, rather than a specific grant (again, the Personnel Policies review example).

While some Executive Directors maintain detailed records of all of their activities which may be used as the basis for charging all of their time to specific cost objectives/cost centers, many report that much of their time is spent in activities which benefit all cost objectives/cost centers within the organization and cannot readily be attributed to specific cost centers. The Personnel Activity Report Toolkit provides useful guidance on maintaining the documentation required to substantiate the allocation of personnel related administrative costs to cost objectives/cost centers. For most Executive Directors, this will mean that while some of their time and effort may be directly associated with providing benefit to specific cost objectives/cost centers, the remaining time and effort will be devoted to activities which provide benefit to all cost centers. The cost of the time devoted to administrative activities which benefit all cost centers must then be allocated using an estimating method, assuming such a method is allowed by the funding source.

Example: The Executive Director of Best CAA completes her Personnel Activity Report for each pay period. She consults her calendar, e-mails, and memory to record the portion of her effort that she has devoted to administrative activities which benefit specific cost centers. In the current pay period (10 working days), she devoted two full days to participating in resolving a complex compliance issue in the Head Start program. She devoted an additional two days to working on the needs assessment being conducted as part of the CSBG program. On the remaining 6 days in the pay period, she noted that she spent at least half of her time preparing for the upcoming Board meeting and the remaining half of her time working with the CFO on preparing the annual budget.

Her Personnel Activity Report will indicate that she devoted 20% of her effort resolving a personnel problem in the Head Start program, 20% of her effort to the CSBG program needs assessment function, 30% of her effort to supporting the Board of Directors, and 30% of her effort to working on the annual budget. Based on her PAR, the accounting department will charge 20% of the cost of the Director's compensation for the pay period to the Head Start award, and 20% to the CSBG award. The remaining 60% of the cost of the Director's compensation will be charged to the Administrative cost center and will then be allocated using an estimating method based on the percentage of all staff time recorded in each cost center during the pay period.

CSBG Treatment of Administrative Costs

CSBG Information Memorandum No. 37: *Definition and Allowability of Direct and Administrative Costs* provides specific guidance for charging administrative costs to CSBG awards. It notes that CSBG statutes permit the treatment of certain costs that would appear to be classified as administrative costs in A-122, as program costs for the purposes of CSBG awards. This approach reflects the intention embodied in the CSBG legislation and reinforced in IM 37 that CSBG funds be utilized to support planning, coordination, integration, strengthening, and expansion of public and private assistance related to the elimination of poverty.

The great value of CSBG flexibility lies in the reality that many funding sources impose percentage limitations on the administrative costs which may be recovered for a specific award. Despite these limitations, A-122 requires that all cost centers that receive benefit from a shared cost be allocated a fair share of those costs. As noted above, it is impermissible under A-122 to allocate shared costs based on the availability of funding, including reducing the share allocated to a cost objective/cost center based on the fact that a funder of that program has imposed a limit on administrative cost.

One approach to utilizing the flexibility of CSBG to address this challenge requires structuring cost objectives by programmatic purposes, establishing sub-cost centers for each of the awards utilized to support the programmatic activity of the cost center. Shared costs are allocated to the programmatic cost objective level. Consequently, the fair share of administrative cost is allocated to each program. All resources provided by all of the different funding sources which support a specific program may be combined to demonstrate that funding is available to cover the fair share of allocated costs assigned to the specific program. Assuming that the activities conducted in a specific

program are eligible for CSBG funding, CSBG may be included as a source of funding for the program. In this way, CSBG can be utilized to cover a portion of the administrative costs correctly allocated to a program which is primarily funded through sources that limit the use of funds for administrative costs.

Great care is needed in using this approach. **CSBG regulations prohibit utilizing CSBG funds to cover a deficiency of funding in another federal program.** The core concept of this approach requires that the activities of the program be allowable for the use of CSBG funds and that the CAA determine that carrying out those activities is an appropriate use of CSBG funds. For this approach to work, the CAA must define all of its cost objectives/cost centers on a program level rather than an award level. CSBG dollars are then utilized to support the program, including shared costs that have been appropriately allocated to the program. The use of CSBG dollars to support this program, as well as all other programs for which CSBG is used, will be combined for the purpose of determining the costs to be charged to the CSBG award. The overall use of CSBG funds must meet CSBG requirements.

Requirements Relating to Administrative Costs in Other Federal Programs

While Circular OMB A-122 is intended to establish cost principles for all nonprofit recipients of federal funds, differing requirements may be established by statutes associated with specific federal programs. Consequently, CAAs must review all awards which include federal dollars to determine whether compliance with the terms of any award will require different treatment of administrative costs than that described in A-122. The most common differences involve the imposition of a limitation of the percentage of an award which may be utilized for administrative or indirect costs. In some cases, there are also statutory definitions of the types of administrative costs that are allowable to be charged to a specific source. See [Dealing With Limits on Indirect Costs](#) below for discussion of how these limitations may be observed while still meeting the fair allocation requirements of A-122.

GAAP and IRS Definitions of Administrative or Management and General Costs

GAAP requires that nonprofit organizations characterize expenses on a functional basis, distinguishing costs incurred for program purposes from those incurred for “supporting services.” The term “supporting services” encompasses both *management and general costs* and the costs of *fundraising*. The GAAP definition of “management” is very similar to the A-122 definition of administrative. The GAAP use of the phrase “and General” refers to the concept discussed as “shared” costs – costs which provide benefit to multiple functions. In practice, most nonprofit organizations treat shared costs in the ways described in this toolkit and use the “management and general” function to report management costs rather than all shared costs.

The IRS also utilizes the phrase “management and general” on Form 990, and defines the costs which may be included in this category in essentially the same way as they are defined in GAAP.

Indirect Costs: Multiple Meanings for the Same Term

As noted in the May 2010 Government Accountability Office (GAO) report *“Nonprofit Sector: Treatment and Reimbursement of Indirect Costs Vary Among Grants, and Depend Significantly on Federal, State, and Local Government Practices,”* there is substantial disagreement about the meaning of the term indirect, even more disagreement about the extent to which federal funds should be utilized to meet such costs. Unfortunately, as the report notes, there are different interpretations of the definition of indirect costs among different programs within the same federal agency and among state agencies responsible for administering the same federal programs and awards. Add to this confusion the reality that the term indirect cost is defined differently by multiple foundations and charity watchdog organizations and you will understand why the term creates so many frustrations and misunderstandings.

Indirect Costs Defined in A-122

A-122 defines indirect costs as “those that have been incurred for common or joint objectives and cannot be readily identified with a particular final cost objective” (A-122 General Principles Section C (1)). Importantly, A-122 specifies that only recipients with an approved indirect cost rate may charge indirect costs to federal awards. A-122 describes two distinct methods for determining which costs should be included in a recipient’s federally negotiated indirect cost rate. In one method, only administrative costs are included in the indirect cost category. In the other method, the term indirect is used to describe the combination of administrative and other shared costs, most commonly facilities costs.

A-122 clearly recognizes that recipients without indirect cost rates incur legitimate costs which benefit multiple cost centers and provides guidance on how the benefit provided to various cost centers may be estimated and charges to various awards substantiated through consistent use of allowable cost allocation methods. (Appendix A to Part 230 Section A. 4(2) & (3))

Definitions of Indirect Cost in State and Local Government Contracts/Awards

Some state and local governments include compliance with A-122 as a requirement for all contracts and awards, including both agreements that involve federal funds and agreements that do not involve federal funds. Consequently, the A-122 definitions and limitations described above will apply to these agreements.

However, some state and local governments choose to permit nonprofit recipients to report and recover line items captioned as “indirect costs.” Such governmental agreements may utilize the A-122 definition of indirect costs with the exception that they permit reporting these costs as indirect costs without a federally negotiated indirect cost rate, which A-122 does not permit. Agreements taking this approach may either require or permit inclusion of non-administrative shared costs as well as administrative costs in the category “indirect costs.” The common thread in these agreements is that administrative costs are included in the use of the term “indirect cost.”

Foundations and Other Private Funders

Some foundations specifically forbid the use of their funds for “indirect costs” while others set limits on the percentage of their funds which may be used for “indirect costs.” Various foundations use varying definitions of the term. To some, the term “indirect” means “administrative” while to others the term “indirect” refers to all shared costs. Make sure you understand what the funder means.

Coping with Multiple Definitions

CAAs which deal with multiple funders utilizing differing definitions of indirect costs must track costs in ways that will support recovering costs from all sources, to the extent allowable. This generally requires identifying administrative costs separately from other shared costs and establishing clear justifications for the allocation methods which will be used for each type of cost.

Dealing with Limits on Indirect and/or Administrative Costs

Many funding agreements include limitations on either the total dollars which may be spent on administrative or indirect costs or the percentage of the total award that may be utilized for administration or indirect costs. However, A-122 requires that costs which provide benefit to multiple cost objectives/cost centers be allocated fairly to reflect the benefit received by each cost center.

This means that shared costs must be allocated fairly to all cost centers that receive benefit regardless of whether the funder of a specific program/cost center imposes limits on the amount of administrative or other shared costs which may be recovered from the award. In such cases, the CAA must be able to demonstrate that it has used an unrestricted source of funds to cover the portion of costs which have been allocated to a cost center for which restricted funders have imposed limitations such as those on administrative or indirect costs. In most cases, it is not acceptable to allow the cost center to operate at a loss caused by the primary funding source refusing to pay its fair share of administrative or other shared costs.

Dealing with this challenge requires preparing a comprehensive annual budget which reflects all sources and uses of funds. The budget will identify all of the shared costs you anticipate incurring during the year and utilize the methods contained in your cost allocation plan to distribute the shared costs to each cost center based upon the relative benefit each shared cost provides to each of the cost centers. You can then compare the estimated allocated costs to any limitations contained in your funding agreements. If you determine that the estimated costs which you anticipate will be



Red Flag Fix

Readily accounting and providing for administrative costs can be difficult especially with restrictions on administrative costs. This section outlines how to account for such limitations.

allocated to a specific cost center are greater than a limit imposed by the funding source for the cost center, you will need to identify an alternative source which may be used to close the gap and ensure funding for the entire fair share of costs which will be charged to the cost center.

The budget is only the starting point. A-122 requires that costs be allocated through analysis of actual benefit provided to various cost centers. You must not only establish a written cost allocation plan that documents the use of allowable allocation methods, you must implement the plan consistently. Review the PARs Toolkit to be sure you are maintaining the records needed to document the actual use of staff time and effort which must be the basis for allocating personnel costs to cost centers and ultimately charging these costs to various awards. Maintaining appropriate records of staff activity is essential to substantiate cost allocation methods based on the use of staff time.

A-122 contains an explicit prohibition against allocating shared costs based on the availability of funds. General Principles Section 4 (b) states “Any cost allocable to a particular award or other cost objective under these principles may not be shifted to other Federal awards to overcome funding deficiencies, or to avoid restrictions imposed by law or by the terms of the award.” Cost allocation methods must result in a fair distribution of shared costs which is based in a reasonable estimate of the benefit provided to various cost centers. Consequently, it is not allowable to deal with a funder limitation on administration or other shared costs by shifting those costs to another cost center/award or by allowing those costs to create a loss. In situations in which a restricted source funding a specific cost center has imposed limitations on certain cost items, including administrative costs, and the actual fair share of those costs exceeds the funding source limitations, the CAA must demonstrate that it has unrestricted funds to cover the costs which exceed the funding source limits. Not surprisingly, the unrestricted funds may only be used to “fill in the gaps” one time. The total of unrestricted funds available must equal or exceed the total demand for funds to cover the “gaps” – that is, the portion of costs legitimately allocated to a cost center which cannot be met with restricted funds supporting that cost center.

Using Your Cost Allocation Plan for Budget Preparation and Grant/Contract Negotiation

Most CAAs must submit grant budget proposals and negotiate final award budgets throughout their fiscal year. It is extremely important to use a consistent approach to allocating shared costs, including administrative costs, in each budget proposal and all final grant budget agreements. Your estimate of the fair share of allocated costs that will be assigned to a particular program or award should be based on your current projection of your overall budget for the period the award will cover. Because proposals must often be submitted months in advance of awards being finalized, it is not unusual for the overall size of the budget or the total number of programs your CAA will operate to have changed. Consequently, it is important to review the latest comprehensive budget projection and determine its implications for shared costs as part of your review process before signing an award agreement.



Red Flag Fix

While you may be able to continue using the methods described in your cost allocation plan for many years, changes in the size of your organization or the composition of your programs and funding may make it more efficient to change allocation methods. At a minimum, you will need to test whether your current cost allocation plan will result in full recovery of your costs through the actual funding agreements which will be in force during a given period.

Of course, actual recovery of costs through an agreement depends upon incurring and properly documenting allowable costs, whether they are costs which may be directly associated with achieving the objectives of the award or portions of shared costs that have been allocated to the award through the use of an appropriate cost allocation plan. Consistent implementation of a compliant cost allocation plan will result in the CAA being able to recover both the costs that are directly attributable to the award cost center and the costs that have been properly allocated to the cost center as “direct” costs. This is extremely important in light of the reality that an organization that does not have a negotiated indirect cost rate may not, in most cases, recover any costs as “indirect” costs.

Impact of Growth, Contraction, and Delays in Program Implementation on Cost Allocation

Growth or contraction in either the number of programs operated or the level of staff effort devoted to various programs may potentially impact the portion of shared costs that may be charged to specific awards.

Example: Best CAA previously allocated shared facility costs among five different programs housed in a common facility based on the percentage of square feet each program utilized. In the middle of their fiscal year, Best discontinued one of the programs but continued to lease the same facility to house the remaining four programs. Best must re-compute the percentage of the facility that each program will utilize and adjust the formula for allocating the costs for use of the facility. The portion of the lease expense allocated to each of the remaining four programs will be higher than it was previously.

If in the next fiscal year Best decides to house six programs in the facility, the share of the cost for the lease allocated to each of the original five programs is lower than it was previously.

Because A-122 requires that cost allocation be based on actual activity or use, rather than planned, it is extremely important that CAAs monitor their cost allocation practices carefully to be certain that allocation formulae reflect actual use. Allocation approaches which are based on the use of staff time must be supported through contemporaneously maintained records of staff activity. The PARs Toolkit provides essential guidance on maintaining such records. But maintaining the records alone is not enough. Your system must ensure that records of actual activity are used as the basis for allocation of shared costs.

At a basic level, you will want to be sure that your system requires regular periodic comparison of summary data from the Personnel Activity Reports with the allocation of personnel costs recorded in the accounting system. The goal of this comparison is to determine that the information supplied in the Personnel Activity Reports is being utilized to allocate the costs of employment for individuals whose time and efforts are devoted to more than one cost center.



Red Flag Fix

Allocations must be based on costs incurred. Monitoring the actual use of staff time and effort, actual use of space, etc. is essential.

The comparison of PARs information and accounting data will be particularly important in organizations utilizing the percentage of FTEs method to allocate certain shared costs such as the components of management that cannot be directly attributed to specific cost centers. To verify that charges to federal awards based on your percentage of FTE allocation method can be substantiated, you will need to compare the percentage of total FTEs calculated on a summary schedule derived from the PARs of all employees with the percentages used to allocate shared costs to award cost centers in the accounting system.

Appendices

Appendix 1 – Annotated CFR Part 230 – Cost Principles for Non-Profit Organizations
(OMB Circular A-122)

Appendix 2 – A-133 Compliance Guide

Appendix 3 – Resource Directory

Appendix 4 – Step-by-Step Guide to Creating a Cost Allocation Plan

Appendix 5 – Pros and Cons of a Federally Negotiated Indirect Cost Rate

Appendix 1 – Annotated CFR Part 230

PART 230—COST PRINCIPLES FOR NON-PROFIT ORGANIZATIONS (OMB CIRCULAR A-122)

Section Contents

[§ 230.5 Purpose.](#)

[§ 230.10 Scope.](#)

[§ 230.15 Policy.](#)

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[§ 230.25 Definitions.](#)

[§ 230.30 OMB responsibilities.](#)

[§ 230.35 Federal agency responsibilities.](#)

[§ 230.40 Effective date of changes.](#)

[§ 230.45 Relationship to previous issuance.](#)

[§ 230.50 Information contact.](#)

[Appendix A to Part 230—General Principles](#)

[Appendix B to Part 230—Selected Items of Cost](#)

[Appendix C to Part 230—Non-Profit Organizations Not Subject to This Part](#)

Authority: 31 U.S.C. 503; 31 U.S.C. 1111; 41 U.S.C. 405; Reorganization Plan No. 2 of 1970; E.O. 11541, 35 FR 10737, 3 CFR, 1966–1970, p. 939

Source: 70 FR 51927, Aug. 31, 2005, unless otherwise noted.

§ 230.5 Purpose.

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This part establishes principles for determining costs of grants, contracts and other agreements with non-profit organizations.

§ 230.10 Scope.

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(a) This part does not apply to colleges and universities which are covered by 2 CFR part 220 Cost Principles for Educational Institutions (OMB Circular A-21); State, local, and federally-recognized Indian tribal governments which are covered by 2 CFR part 225 Cost Principles for State, Local, and Indian Tribal Governments (OMB Circular A-87); or hospitals.

(b) The principles deal with the subject of cost determination, and make no attempt to identify the circumstances or dictate the extent of agency and non-profit organization participation in the

financing of a particular project. Provision for profit or other increment above cost is outside the scope of this part.

§ 230.15 Policy.

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The principles are designed to provide that the Federal Government bear its fair share of costs except where restricted or prohibited by law. The principles do not attempt to prescribe the extent of cost sharing or matching on grants, contracts, or other agreements. However, such cost sharing or matching shall not be accomplished through arbitrary limitations on individual cost elements by Federal agencies.

§ 230.20 Applicability.

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(a) These principles shall be used by all Federal agencies¹ in determining the costs of work performed by non-profit organizations under grants, cooperative agreements, cost reimbursement contracts, and other contracts in which costs are used in pricing, administration, or settlement. All of these instruments are hereafter referred to as awards.² The principles do not apply to awards under which an organization is not required to account to the Federal Government for actual costs incurred.³

(b) All cost reimbursement subawards (subgrants, subcontracts, etc.) are subject to those Federal cost principles applicable to the particular organization concerned. Thus, if a subaward is to a non-profit organization, this part shall apply⁴; if a subaward is to a commercial organization, the cost principles applicable to commercial concerns shall apply; if a subaward is to a college or university, 2 CFR part 220 shall apply; if a subaward is to a State, local, or federally-recognized Indian tribal government, 2 CFR part 225 shall apply.

(c) Exclusion of some non-profit organizations. Some non-profit organizations, because of their size and nature of operations, can be considered to be similar to commercial concerns for purpose of applicability of cost principles. Such non-profit organizations shall operate under Federal cost principles applicable to commercial concerns. A listing of these organizations is contained in appendix C to this part. Other organizations may be added from time to time.

§ 230.25 Definitions.

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1. If a federal statute that governs a specific federal program, such as the authorizing legislation or appropriations bill, is inconsistent with A-122, then that specific federal provision will trump the A-122 provision. The federal CSBG Act specifically requires states to ensure that the OMB cost standards, i.e. A-122 for nonprofits and A-87 for public CAAs, apply to recipients of CSBG.

2. Term "award" is used for grants, cooperative agreements, cost reimbursement agreements & certain other cost-based agreements.

3. Does not apply to vendor agreements- applicability parallels requirements for A-133 audits. It also only applies to grants that are paid on a cost-reimbursement basis.

4. Applies to subawards to nonprofits regardless of whether the primary award is to a governmental or educational entity. Recipients of federal awards making subawards to nonprofits may establish more restrictive requirements for cost determination through subaward agreements, so long as it is consistent with the federal cost principles, furthers the purpose of the subaward, and, if it is a state or local government entity, is authorized by state law to impose such additional requirements, including any applicable state administrative requirements to provide an opportunity to the public to comment on the proposed rule.

(a) Non-profit organization means any corporation, trust, association, cooperative, or other organization which⁵:

(1) Is operated primarily for scientific, educational, service, charitable, or similar purposes in the public interest;

(2) Is not organized primarily for profit; and

(3) Uses its net proceeds to maintain, improve, and/or expand its operations. For this purpose, the term “non-profit organization” excludes colleges and universities; hospitals; State, local, and federally-recognized Indian tribal governments; and those non-profit organizations which are excluded from coverage of this part in accordance with §230.20(c).

(b) Prior approval means securing the awarding agency's permission in advance to⁶ incur cost for those items that are designated as requiring prior approval by the part and its appendices. Generally this permission will be in writing. Where an item of cost requiring prior approval is specified in the budget of an award, approval of the budget constitutes approval of that cost⁷.

§ 230.30 OMB responsibilities.

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OMB may grant exceptions to the requirements of this part when permissible under existing law. However, in the interest of achieving maximum uniformity, exceptions will be permitted only in highly unusual circumstances.

§ 230.35 Federal agency responsibilities.

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The head of each Federal agency that awards and administers grants and agreements subject to this part is responsible for requesting approval from and/or consulting with OMB (as applicable) for deviations from the guidance in the appendices to this part and performing the applicable functions specified in the appendices to this part⁸.

§ 230.40 Effective date of changes.

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The provisions of this part are effective August 31, 2005. Implementation shall be phased in by incorporating the provisions into new awards made after the start of the organization's next fiscal year. For existing awards, the new principles may be applied if an organization and the

5. Description parallels requirements for 501(c)(3) charitable nonprofits, but applies to such organizations whether or not they have obtained 501(c)(3) determination from the IRS.

6. If prior approval is required for the cost to be allowable, failure to obtain prior approval will USUALLY result in the cost being unallowable, although the HHS Departmental Appeals Board has occasionally allowed such costs where the funding agency would have approved the cost if it had been presented beforehand.

7. Care is needed with this provision. The cost item must be spelled out very specifically for its inclusion in the approved budget to be considered prior approval and it must not be an unallowable good or service.

8. This means that, unless the federal legislation specifically imposes the OMB cost principles, as the CSBG Act does, the federal funding agency must adopt the cost principles through regulation in order for them to be imposed on award recipients. HHS has done so in 45 CFR Part 74, and other agencies have done so as well. Sometimes the individual federal agencies' adoption of the principles differs slightly from A-122.

cognizant⁹ Federal agency agree. Earlier implementation, or a delay in implementation of individual provisions, is also permitted by mutual agreement between an organization and the cognizant Federal agency.

§ 230.45 Relationship to previous issuance.

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(a) The guidance in this part previously was issued as OMB Circular A–122. Appendix A to this part contains the guidance that was in Attachment A (general principles) to the OMB circular; Appendix B contains the guidance that was in Attachment B (selected items of cost) to the OMB circular; and Appendix C contains the information that was in Attachment C (non-profit organizations not subject to the Circular) to the OMB circular.

(b) Historically, OMB Circular A–122 superseded cost principles issued by individual agencies for non-profit organizations.

9. Defined in General Principles Section E (1) (a).

10. Includes requirements for allocating shared costs and for negotiating indirect cost rates.

§ 230.50 Information contact.

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Further information concerning this part may be obtained by contacting the Office of Federal Financial Management, OMB, Washington, DC 20503, telephone (202) 395–3993.

Appendix A to Part 230—General Principles¹⁰

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General Principles

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General Principles

A. Basic Considerations

1. Composition of total costs. The total cost of an award is the sum of the allowable direct and allocable indirect costs less any applicable credits.

2. Factors affecting allowability of costs. To be allowable under an award, costs must meet the following general criteria:

a. Be reasonable for the performance of the award and be allocable thereto under these principles.¹¹

b. Conform to any limitations or exclusions set forth in these principles or in the award as to types or amount of cost items.

c. Be consistent with policies and procedures that apply uniformly to both federally-financed and other activities of the organization.

d. Be accorded consistent treatment.

e. Be determined in accordance with generally accepted accounting principles (GAAP¹²).

f. Not be included as a cost or used to meet cost sharing or matching requirements of any other federally-financed program in either the current or a prior period¹³.

g. Be adequately documented¹⁴.

3. Reasonable costs. A cost is reasonable if, in its nature or amount, it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the costs. The question of the reasonableness of specific costs must be scrutinized with particular care in connection with organizations or separate divisions thereof which receive the preponderance of their support from awards made by Federal agencies. In determining the reasonableness of a given cost, consideration shall be given to:

a. Whether the cost is of a type generally recognized as ordinary and necessary for the operation of the organization or the performance of the award.

11. Requires consistent use of cost allocation methods to allocate shared costs fairly to all activities, both those financed through federal awards and those financed through other sources.

12. Must use Generally Accepted Accounting Principles to determine costs.

13. Cannot attribute the same cost to multiple awards – no double counting. Cannot use a cost incurred for a federally financed award to meet cost sharing or matching requirements of any other federal award.

14. Pay particular attention to documenting allocations of shared costs and to documenting personnel costs – see PARs Toolkit.

b. The restraints or requirements imposed by such factors as generally accepted sound business practices, arms length bargaining, Federal and State laws and regulations, and terms and conditions of the award.

c. Whether the individuals concerned acted with prudence in the circumstances, considering their responsibilities to the organization, its members, employees, and clients, the public at large, and the Federal Government.

d. Significant deviations from the established practices of the organization which may unjustifiably increase the award costs.

4. Allocable costs. a. A cost is allocable to a particular cost objective¹⁵, such as a grant, contract, project, service, or other activity, in accordance with the relative benefits received¹⁶. A cost is allocable to a Federal award if it is treated consistently with other costs incurred for the same purpose in like circumstances and if it:

(1) Is incurred specifically for the award¹⁷.

(2) Benefits both the award and other work¹⁸ and can be distributed in reasonable proportion to the benefits received, or

(3) Is necessary to the overall operation of the organization¹⁹, although a direct relationship to any particular cost objective cannot be shown.

b. Any cost allocable to a particular award or other cost objective under these principles may not be shifted to other Federal awards to overcome funding deficiencies, or to avoid restrictions imposed by law or by the terms of the award²⁰.

5. Applicable credits. a. The term applicable credits refers to those receipts, or reduction of expenditures which operate to offset or reduce expense items that are allocable to awards as direct or indirect costs. Typical examples of such transactions are: Purchase discounts, rebates or allowances, recoveries or indemnities on losses, insurance refunds, and adjustments of overpayments or erroneous charges. To the extent that such credits accruing or received by the organization relate to allowable cost, they shall be credited to the Federal Government either as a cost reduction or cash refund, as appropriate.

b. In some instances, the amounts received from the Federal Government to finance organizational activities or service operations should be treated as applicable credits. Specifically, the concept of netting such credit items against related expenditures should be

15. Note – Toolkit refers to Cost Objectives as Cost Centers.

16. Core goal of cost allocation is estimating the relative benefit received by particular cost objectives. Note that a cost objective may be defined as a specific funding agreement or a specific project, service or activity – see discussion in Toolkit on potential benefits of defining cost objective on a program or project level.

17. Direct Cost.

18. Described as “shared costs” in the Toolkit.

19. Justification for allowing costs which cannot be directly attributed to specific cost objectives.

20. Special care is required to observe this provision. Cost shifting - assigning costs which actually benefit one cost objective to another cost objective because the first cost objective does not have funds available to cost the cost - is specifically forbidden.

applied by the organization in determining the rates or amounts to be charged to Federal awards for services rendered whenever the facilities or other resources used in providing such services have been financed directly, in whole or in part, by Federal funds.

c. For rules covering program income (i.e., gross income earned from federally-supported activities) see §215.24 of 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).

6. Advance understandings. Under any given award, the reasonableness and allocability of certain items of costs may be difficult to determine. This is particularly true in connection with organizations that receive a preponderance of their support from Federal agencies. In order to avoid subsequent disallowance or dispute based on unreasonableness or nonallocability, it is often desirable to seek a written agreement with the cognizant or awarding agency in advance of the incurrence of special or unusual costs. The absence of an advance agreement on any element of cost will not, in itself, affect the reasonableness or allocability of that element²¹.

7. Conditional exemptions. a. OMB authorizes conditional exemption from OMB administrative requirements and cost principles for certain Federal programs with statutorily-authorized consolidated planning and consolidated administrative funding, that are identified by a Federal agency and approved by the head of the Executive department or establishment. A Federal agency shall consult with OMB during its consideration of whether to grant such an exemption.

b. To promote efficiency in State and local program administration, when Federal non-entitlement programs with common purposes have specific statutorily-authorized consolidated planning and consolidated administrative funding and where most of the State agency's resources come from non-Federal sources, Federal agencies may exempt these covered State-administered, non-entitlement grant programs from certain OMB grants management requirements. The exemptions would be from all but the allocability of costs provisions of Appendix A, subsection C.e. of 2 CFR part 225 (OMB Circular A-87); Appendix A, Section C.4. of 2 CFR part 220 (OMB Circular A-21); Section A.4. of this appendix²²; and from all of the administrative requirements provisions of 2 CFR part 215 (OMB Circular A-110) and the agencies' grants management common rule.

c. When a Federal agency provides this flexibility, as a prerequisite to a State's exercising this option, a State must adopt its own written fiscal and administrative requirements for expending and accounting for all funds, which are consistent with the provisions of 2 CFR part 225 (OMB Circular A-87), and extend such policies to all subrecipients. These fiscal and administrative requirements must be sufficiently specific to ensure that: Funds are used in compliance with all applicable Federal statutory and regulatory provisions, costs are reasonable and necessary for

21. Provides support for the allowability of properly allocated costs even when it has not been possible to obtain written approval of a cost allocation plan.

22. Even states receiving exemptions from certain federal requirements are not exempted from the allocability of costs provisions in A-122 for their sub-awards to nonprofits.

operating these programs, and funds are not to be used for general expenses required to carry out other responsibilities of a State or its subrecipients.

B. Direct Costs

1. Direct costs are those that can be identified specifically with a particular final cost objective, i.e., a particular award, project, service, or other direct activity of an organization²³. However, a cost may not be assigned to an award as a direct cost if any other cost incurred for the same purpose, in like circumstance, has been allocated to an award as an indirect cost. Costs identified specifically with awards are direct costs of the awards and are to be assigned directly thereto. Costs identified specifically with other final cost objectives of the organization are direct costs of those cost objectives and are not to be assigned to other awards directly or indirectly²⁴.

2. Any direct cost of a minor amount may be treated as an indirect cost for reasons of practicality where the accounting treatment for such cost is consistently applied to all final cost objectives.

3. The cost of certain activities are not allowable as charges to Federal awards (see, for example, fundraising costs in paragraph 17 of Appendix B to this part). However, even though these costs are unallowable for purposes of computing charges to Federal awards, they nonetheless must be treated as direct costs for purposes of determining indirect cost rates and be allocated their share of the organization's indirect costs if they represent activities which include the salaries of personnel, occupy space, and benefit from the organization's indirect costs²⁵.

4. The costs of activities performed primarily as a service to members, clients, or the general public when significant and necessary to the organization's mission must be treated as direct costs whether or not allowable and be allocated an equitable share of indirect costs. Some examples of these types of activities include:

- a. Maintenance of membership rolls, subscriptions, publications, and related functions.
- b. Providing services and information to members, legislative or administrative bodies, or the public.
- c. Promotion, lobbying, and other forms of public relations.
- d. Meetings and conferences except those held to conduct the general administration of the organization.

23. Core guidance on direct costs.

24. This provision prohibits treating costs which can readily be directly attributed to one cost objective as shared costs and allocating them among multiple cost centers. Only costs that benefit multiple cost centers may be allocated.

25. While this provision addresses calculation of indirect cost rates, the underlying logic requires that cost allocation plans fairly allocate shared costs among all cost centers which receive benefit. For example, a CAA that has established a cost center to track lobbying expenses, which are not allowable as a use of federal funds, must share the cost of common facilities fairly among all cost centers, including the cost center that contains costs unallowable for federal funding purposes.

e. Maintenance, protection, and investment of special funds not used in operation of the organization.

f. Administration of group benefits on behalf of members or clients, including life and hospital insurance, annuity or retirement plans, financial aid, etc.

C. Indirect Costs

1. Indirect costs are those that have been incurred for common or joint objectives and cannot be readily identified with a particular final cost objective²⁶. Direct cost of minor amounts may be treated as indirect costs under the conditions described in subparagraph B.2 of this appendix. After direct costs have been determined and assigned directly to awards or other work as appropriate, indirect costs are those remaining to be allocated to benefiting cost objectives. A cost may not be allocated to an award as an indirect cost if any other cost incurred for the same purpose, in like circumstances, has been assigned to an award as a direct cost.

2. Because of the diverse characteristics and accounting practices of non-profit organizations, it is not possible to specify the types of cost which may be classified as indirect cost in all situations. However, typical examples of indirect cost for many non-profit organizations may include depreciation or use allowances on buildings and equipment, the costs of operating and maintaining facilities, and general administration and general expenses, such as the salaries and expenses of executive officers, personnel administration, and accounting²⁷.

3. Indirect costs shall be classified within two broad categories: “Facilities” and “Administration.” “Facilities” is defined as depreciation and use allowances on buildings, equipment and capital improvement, interest on debt associated with certain buildings, equipment and capital improvements, and operations and maintenance expenses. “Administration” is defined as general administration and general expenses such as the director's office, accounting, personnel, library expenses and all other types of expenditures not listed specifically under one of the subcategories of “Facilities” (including cross allocations from other pools, where applicable)²⁸. See indirect cost rate reporting requirements in subparagraphs D.2.e and D.3.g of this appendix.

26. Core definition of indirect costs.

27. Examples of indirect costs.

28. Core definition of administrative costs.

29. Section describes methods of determining indirect cost rates- guidance for preparing indirect cost rate proposals. Most auditors do not believe that this section may be used as the basis for designing a cost allocation plan for organizations that do not obtain a negotiated indirect cost rate because the purpose of guidance is clarifying what may and may not be included in an indirect cost rate, rather than describing methods for allocating shared costs for use without a negotiated indirect cost rate.

D. Allocation of Indirect Costs and Determination of Indirect Cost Rates²⁹

1. General. a. Where a non-profit organization has only one major function, or where all its major functions benefit from its indirect costs to approximately the same degree, the allocation of indirect costs and the computation of an indirect cost rate may be accomplished through simplified allocation procedures, as described in subparagraph D.2 of this appendix.

b. Where an organization has several major functions which benefit from its indirect costs in varying degrees, allocation of indirect costs may require the accumulation of such costs into separate cost groupings which then are allocated individually to benefiting functions by means of a base which best measures the relative degree of benefit. The indirect costs allocated to each function are then distributed to individual awards and other activities included in that function by means of an indirect cost rate(s).

c. The determination of what constitutes an organization's major functions will depend on its purpose in being; the types of services it renders to the public, its clients, and its members; and the amount of effort it devotes to such activities as fundraising, public information and membership activities.

d. Specific methods for allocating indirect costs and computing indirect cost rates along with the conditions under which each method should be used are described in subparagraphs D.2 through 5 of this appendix.

e. The base period for the allocation of indirect costs is the period in which such costs are incurred and accumulated for allocation to work performed in that period. The base period normally should coincide with the organization's fiscal year but, in any event, shall be so selected as to avoid inequities in the allocation of the costs.

2. Simplified allocation method³⁰. a. Where an organization's major functions benefit from its indirect costs to approximately the same degree, the allocation of indirect costs may be accomplished by separating the organization's total costs for the base period as either direct or indirect, and dividing the total allowable indirect costs (net of applicable credits) by an equitable distribution base. The result of this process is an indirect cost rate which is used to distribute indirect costs to individual awards. The rate should be expressed as the percentage which the total amount of allowable indirect costs bears to the base selected. This method should also be used where an organization has only one major function encompassing a number of individual projects or activities, and may be used where the level of Federal awards to an organization is relatively small.

30. Generally interpreted to apply only to nonprofits seeking negotiated indirect cost rates.

b. Both the direct costs and the indirect costs shall exclude capital expenditures and unallowable costs. However, unallowable costs which represent activities must be included in the direct costs under the conditions described in subparagraph B.3 of this appendix.

c. The distribution base may be total direct costs (excluding capital expenditures and other distorting items, such as major subcontracts or subgrants), direct salaries and wages, or other base which results in an equitable distribution. The distribution base shall generally exclude participant support costs as defined in paragraph 32 of Appendix B.

d. Except where a special rate(s) is required in accordance with subparagraph 5 of this appendix, the indirect cost rate developed under the above principles is applicable to all awards at the

organization. If a special rate(s) is required, appropriate modifications shall be made in order to develop the special rate(s).

e. For an organization that receives more than \$10 million in Federal funding of direct costs in a fiscal year, a breakout of the indirect cost component into two broad categories, Facilities and Administration as defined in subparagraph C.3 of this appendix, is required. The rate in each case shall be stated as the percentage which the amount of the particular indirect cost category (i.e. , Facilities or Administration) is of the distribution base identified with that category.

3. Multiple allocation base method³¹.

31. Applicable to negotiation of indirect cost rates.

a. General. Where an organization's indirect costs benefit its major functions in varying degrees, indirect costs shall be accumulated into separate cost groupings, as described in subparagraph D.3.b of this appendix. Each grouping shall then be allocated individually to benefiting functions by means of a base which best measures the relative benefits. The default allocation bases by cost pool are described in subparagraph D.3.c of this appendix.

b. Identification of indirect costs. Cost groupings shall be established so as to permit the allocation of each grouping on the basis of benefits provided to the major functions. Each grouping shall constitute a pool of expenses that are of like character in terms of functions they benefit and in terms of the allocation base which best measures the relative benefits provided to each function. The groupings are classified within the two broad categories: "Facilities" and "Administration," as described in subparagraph C.3 of this appendix. The indirect cost pools are defined as follows:

(1) Depreciation and use allowances. The expenses under this heading are the portion of the costs of the organization's buildings, capital improvements to land and buildings, and equipment which are computed in accordance with paragraph 11 of Appendix B to this part ("Depreciation and use allowances").

(2) Interest. Interest on debt associated with certain buildings, equipment and capital improvements are computed in accordance with paragraph 23 of Appendix B to this part ("Interest").

(3) Operation and maintenance expenses. The expenses under this heading are those that have been incurred for the administration, operation, maintenance, preservation, and protection of the organization's physical plant. They include expenses normally incurred for such items as: janitorial and utility services; repairs and ordinary or normal alterations of buildings, furniture and equipment; care of grounds; maintenance and operation of buildings and other plant facilities; security; earthquake and disaster preparedness; environmental safety; hazardous waste disposal; property, liability and other insurance relating to property; space and capital leasing; facility planning and management; and, central receiving. The operation and maintenance expenses category shall also include its allocable share of fringe benefit costs, depreciation and use allowances, and interest costs.

(4) General administration and general expenses. (a) The expenses under this heading are those that have been incurred for the overall general executive and administrative offices of the organization and other expenses of a general nature which do not relate solely to any major function of the organization. This category shall also include its allocable share of fringe benefit costs, operation and maintenance expense, depreciation and use allowances, and interest costs. Examples of this category include central offices, such as the director's office, the office of finance, business services, budget and planning, personnel, safety and risk management, general counsel, management information systems, and library costs.

(b) In developing this cost pool, special care should be exercised to ensure that costs incurred for the same purpose in like circumstances are treated consistently as either direct or indirect costs. For example, salaries of technical staff, project supplies, project publication, telephone toll charges, computer costs, travel costs, and specialized services costs shall be treated as direct costs wherever identifiable to a particular program. The salaries and wages of administrative and pooled clerical staff should normally be treated as indirect costs. Direct charging of these costs may be appropriate where a major project or activity explicitly requires and budgets for administrative or clerical services and other individuals involved can be identified with the program or activity. Items such as office supplies, postage, local telephone costs, periodicals and memberships should normally be treated as indirect costs.

c. Allocation bases. Actual³² conditions shall be taken into account in selecting the base to be used in allocating the expenses in each grouping to benefiting functions. The essential consideration in selecting a method or a base is that it is the one best suited for assigning the pool of costs to cost objectives in accordance with benefits derived; a traceable cause and effect relationship; or logic and reason, where neither the cause nor the effect of the relationship is determinable. When an allocation can be made by assignment of a cost grouping directly to the function benefited, the allocation shall be made in that manner. When the expenses in a cost grouping are more general in nature, the allocation shall be made through the use of a selected base which produces results that are equitable to both the Federal Government and the organization. The distribution shall be made in accordance with the bases described herein unless it can be demonstrated that the use of a different base would result in a more equitable allocation of the costs, or that a more readily available base would not increase the costs charged to sponsored awards. The results of special cost studies (such as an engineering utility study) shall not be used to determine and allocate the indirect costs to sponsored awards.

32. While this guidance is intended for use in the determination of indirect cost rates, it also provides a clear description of basic cost allocation principles which may be useful for organizations developing cost allocation plans and evaluating potential methods for estimating the benefit provided to multiple cost centers by various shared costs.

(1) Depreciation and use allowances. Depreciation and use allowances expenses shall be allocated in the following manner:

(a) Depreciation or use allowances on buildings used exclusively in the conduct of a single function, and on capital improvements and equipment used in such buildings, shall be assigned to that function.

(b) Depreciation or use allowances on buildings used for more than one function, and on capital improvements and equipment used in such buildings, shall be allocated to the individual functions performed in each building on the basis of usable square feet of space, excluding common areas, such as hallways, stairwells, and restrooms³³.

(c) Depreciation or use allowances on buildings, capital improvements and equipment related space (e.g. , individual rooms, and laboratories) used jointly by more than one function (as determined by the users of the space) shall be treated as follows. The cost of each jointly used unit of space shall be allocated to the benefiting functions on the basis of either the employees and other users on a full-time equivalent (FTE) basis or salaries and wages of those individual functions benefiting from the use of that space; or organization-wide employee FTEs or salaries and wages applicable to the benefiting functions of the organization.

33. Although the provision is intended for organizations negotiating indirect cost rates, this section provides useful guidance for cost allocation methods.

34. See 30, above.

(d) Depreciation or use allowances on certain capital improvements to land, such as paved parking areas, fences, sidewalks, and the like, not included in the cost of buildings, shall be allocated to user categories on a FTE basis³⁴ and distributed to major functions in proportion to the salaries and wages of all employees applicable to the functions.

(2) Interest. Interest costs shall be allocated in the same manner as the depreciation or use allowances on the buildings, equipment and capital equipments to which the interest relates.

(3) Operation and maintenance expenses. Operation and maintenance expenses shall be allocated in the same manner as the depreciation and use allowances.

(4) General administration and general expenses. General administration and general expenses shall be allocated to benefiting functions based on modified total direct costs (MTDC), as described in subparagraph D.3.f of this appendix. The expenses included in this category could be grouped first according to major functions of the organization to which they render services or provide benefits. The aggregate expenses of each group shall then be allocated to benefiting functions based on MTDC.

d. Order of distribution. (1) Indirect cost categories consisting of depreciation and use allowances, interest, operation and maintenance, and general administration and general expenses shall be allocated in that order to the remaining indirect cost categories as well as to the major functions of the organization. Other cost categories could be allocated in the order determined to be most appropriate by the organization. When cross allocation of costs is made as provided in subparagraph D.3.d.(2) of this appendix, this order of allocation does not apply.

(2) Normally, an indirect cost category will be considered closed once it has been allocated to other cost objectives, and costs shall not be subsequently allocated to it. However, a cross allocation of costs between two or more indirect costs categories could be used if such allocation will result in a more equitable allocation of costs. If a cross allocation is used, an appropriate modification to the composition of the indirect cost categories is required.

e. Application of indirect cost rate or rates. Except³⁵ where a special indirect cost rate(s) is required in accordance with subparagraph D.5 of this appendix, the separate groupings of indirect costs allocated to each major function shall be aggregated and treated as a common pool for that function. The costs in the common pool shall then be distributed to individual awards included in that function by use of a single indirect cost rate.

f. Distribution basis. Indirect costs shall be distributed to applicable sponsored awards and other benefiting activities within each major function on the basis of MTDC. MTDC consists of all salaries and wages, fringe benefits, materials and supplies, services, travel, and subgrants and subcontracts up to the first \$25,000 of each subgrant or subcontract (regardless of the period covered by the subgrant or subcontract). Equipment, capital expenditures, charges for patient care, rental costs and the portion in excess of \$25,000 shall be excluded from MTDC. Participant support costs shall generally be excluded from MTDC. Other items may only be excluded when the Federal cost cognizant agency determines that an exclusion is necessary to avoid a serious inequity in the distribution of indirect costs.

g. Individual Rate Components. An indirect cost rate shall be determined for each separate indirect cost pool developed. The rate in each case shall be stated as the percentage which the amount of the particular indirect cost pool is of the distribution base identified with that pool. Each indirect cost rate negotiation or determination agreement shall include development of the rate for each indirect cost pool as well as the overall indirect cost rate. The indirect cost pools shall be classified within two broad categories: "Facilities" and "Administration," as described in subparagraph C.3 of this appendix.

4. Direct allocation method. a. Some non-profit organizations treat all costs as direct costs except general administration and general expenses. These organizations generally separate their costs into three basic categories: General administration and general expenses, fundraising, and other direct functions (including projects performed under Federal awards). Joint costs, such as depreciation, rental costs, operation and maintenance of facilities, telephone expenses, and the like are prorated individually as direct costs to each category and to each award or other activity using a base most appropriate to the particular cost being prorated.

b. This method is acceptable, provided each joint cost is prorated using a base which accurately measures the benefits provided to each award or other activity. The bases must be established in accordance with reasonable criteria, and be supported by current data. This method is compatible with the Standards of Accounting and Financial Reporting for Voluntary Health and Welfare Organizations issued jointly by the National Health Council, Inc., the National Assembly of Voluntary Health and Social Welfare Organizations, and the United Way of America.

35. This discussion of applying an indirect cost rate or rates applies to organizations obtaining a negotiated indirect cost rate. Organizations without a negotiated indirect cost rate are not permitted to recover indirect costs as a line item. As discussed in the Toolkit, organizations without federal indirect cost rates must establish cost allocation plans which estimate the benefit which various shared costs provided to each cost center and allocate such costs when incurred to appropriate line items such as Personnel, Facilities, etc.

c. Under this method, indirect costs consist exclusively of general administration and general expenses. In all other respects, the organization's indirect cost rates shall be computed in the same manner as that described in subparagraph D.2 of this appendix³⁶.

5. Special indirect cost rates. In some instances, a single indirect cost rate for all activities of an organization or for each major function of the organization may not be appropriate, since it would not take into account those different factors which may substantially affect the indirect costs applicable to a particular segment of work. For this purpose, a particular segment of work may be that performed under a single award or it may consist of work under a group of awards performed in a common environment. These factors may include the physical location of the work, the level of administrative support required, the nature of the facilities or other resources employed, the scientific disciplines or technical skills involved, the organizational arrangements used, or any combination thereof. When a particular segment of work is performed in an environment which appears to generate a significantly different level of indirect costs, provisions should be made for a separate indirect cost pool applicable to such work. The separate indirect cost pool should be developed during the course of the regular allocation process, and the separate indirect cost rate resulting therefrom should be used, provided it is determined that the rate differs significantly from that which would have been obtained under subparagraphs D.2, 3, and 4 of this appendix, and the volume of work to which the rate would apply is material.

36. This provision applies only to organizations negotiating indirect cost rates. However, the option provided here to use the term indirect costs to describe only administration and general expenses when combined with the provisions for defining indirect costs as including both administration and common facilities and other shared costs is one element in the frequent common speech confusion about the meaning of the term "indirect costs".

37. This entire section applies only to organizations negotiating indirect cost rates.

38. Definition of cognizant agency.

E. Negotiation and Approval of Indirect Cost Rates³⁷

1. Definitions. As used in this section, the following terms have the meanings set forth below:

a. Cognizant agency³⁸ means the Federal agency responsible for negotiating and approving indirect cost rates for a non-profit organization on behalf of all Federal agencies.

b. Predetermined rate means an indirect cost rate, applicable to a specified current or future period, usually the organization's fiscal year. The rate is based on an estimate of the costs to be incurred during the period. A predetermined rate is not subject to adjustment.

c. Fixed rate means an indirect cost rate which has the same characteristics as a predetermined rate, except that the difference between the estimated costs and the actual costs of the period covered by the rate is carried forward as an adjustment to the rate computation of a subsequent period.

d. Final rate means an indirect cost rate applicable to a specified past period which is based on the actual costs of the period. A final rate is not subject to adjustment.

e. Provisional rate or billing rate means a temporary indirect cost rate applicable to a specified period which is used for funding, interim reimbursement, and reporting indirect costs on awards pending the establishment of a final rate for the period.

f. Indirect cost proposal means the documentation prepared by an organization to substantiate its claim for the reimbursement of indirect costs. This proposal provides the basis for the review and negotiation leading to the establishment of an organization's indirect cost rate.

g. Cost objective means a function, organizational subdivision, contract, grant, or other work unit for which cost data are desired and for which provision is made to accumulate and measure the cost of processes, projects, jobs and capitalized projects.

2. Negotiation and approval of rates. a. Unless different arrangements are agreed to by the agencies concerned, the Federal agency with the largest dollar value of awards with an organization will be designated as the cognizant agency for the negotiation and approval of the indirect cost rates and, where necessary, other rates such as fringe benefit and computer charge-out rates. Once an agency is assigned cognizance for a particular non-profit organization, the assignment will not be changed unless there is a major long-term shift in the dollar volume of the Federal awards to the organization. All concerned Federal agencies shall be given the opportunity to participate in the negotiation process but, after a rate has been agreed upon, it will be accepted by all Federal agencies. When a Federal agency has reason to believe that special operating factors affecting its awards necessitate special indirect cost rates in accordance with subparagraph D.5 of this appendix, it will, prior to the time the rates are negotiated, notify the cognizant agency.

b. A non-profit organization which has not previously established an indirect cost rate with a Federal agency shall submit its initial indirect cost proposal immediately after the organization is advised that an award will be made and, in no event, later than three months after the effective date of the award.

c. Organizations that have previously established indirect cost rates must submit a new indirect cost proposal to the cognizant agency within six months after the close of each fiscal year.

d. A predetermined rate may be negotiated for use on awards where there is reasonable assurance, based on past experience and reliable projection of the organization's costs, that the rate is not likely to exceed a rate based on the organization's actual costs.

e. Fixed rates may be negotiated where predetermined rates are not considered appropriate. A fixed rate, however, shall not be negotiated if all or a substantial portion of the organization's awards are expected to expire before the carry-forward adjustment can be made; the mix of Federal and non-Federal work at the organization is too erratic to permit an equitable carry-forward adjustment; or the organization's operations fluctuate significantly from year to year.

f. Provisional and final rates shall be negotiated where neither predetermined nor fixed rates are appropriate.

g. The results of each negotiation shall be formalized in a written agreement between the cognizant agency and the non-profit organization. The cognizant agency shall distribute copies of the agreement to all concerned Federal agencies.

h. If a dispute arises in a negotiation of an indirect cost rate between the cognizant agency and the non-profit organization, the dispute shall be resolved in accordance with the appeals procedures of the cognizant agency.

i. To the extent that problems are encountered among the Federal agencies in connection with the negotiation and approval process, OMB will lend assistance as required to resolve such problems in a timely manner.

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Selected Items of Cost⁴⁰

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39. Includes requirements for allocating shared costs and for negotiating indirect cost rates.

40. Note: list is not all inclusive – failure to appear in the list does not mean that a cost is unallowable.

41. CAPLAW Publication “Right on the Money- Annotated Guide to A-122” provides an excellent discussion of each of the Selected Items of Costs included in Attachment B.

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Appendix B to Part 230—Selected Items of Cost

Paragraphs 1 through 52 of this appendix provide principles to be applied in establishing the allowability of certain items of cost. These principles apply whether a cost is treated as direct or indirect. Failure to mention a particular item of cost is not intended to imply that it is unallowable; rather, determination as to allowability in each case should be based on the treatment or principles provided for similar or related items of cost.

1. Advertising and public relations costs.

a. The term advertising costs means the costs of advertising media and corollary administrative costs. Advertising media include magazines, newspapers, radio and television, direct mail, exhibits, electronic or computer transmittals, and the like.

b. The term public relations includes community relations and means those activities dedicated to maintaining the image of the non-profit organization or maintaining or promoting understanding and favorable relations with the community or public at large or any segment of the public.

c. The only allowable advertising costs are those which are solely for:

(1) The recruitment of personnel required for the performance by the non-profit organization of obligations arising under a Federal award (See also paragraph 41, Recruiting costs, and paragraph 42, Relocation costs, of this appendix);

(2) The procurement of goods and services for the performance of a Federal award;

(3) The disposal of scrap or surplus materials acquired in the performance of a Federal award except when non-profit organizations are reimbursed for disposal costs at a predetermined amount; or

(4) Other specific purposes necessary to meet the requirements of the Federal award.

d. The only allowable public relations costs are:

(1) Costs specifically required by the Federal award;

(2) Costs of communicating with the public and press pertaining to specific activities or accomplishments which result from performance of Federal awards (these costs are considered necessary as part of the outreach effort for the Federal award); or

(3) Costs of conducting general liaison with news media and government public relations officers, to the extent that such activities are limited to communication and liaison necessary keep the public informed on matters of public concern, such as notices of Federal contract/grant awards, financial matters, etc.⁴²

42. These costs are likely to provide benefit to multiple cost centers and require application of a reasonable cost allocation method.

e. Costs identified in subparagraphs c and d if incurred for more than one Federal award or for both sponsored work and other work of the non-profit organization, are allowable to the extent that the principles in Appendix A to this part, paragraphs B. (“Direct Costs”) and C. (“Indirect Costs”) are observed.

f. Unallowable advertising and public relations costs include the following:

(1) All advertising and public relations costs other than as specified in subparagraphs c, d, and e;

(2) Costs of meetings, conventions, convocations, or other events related to other activities of the non-profit organization, including:

(a) Costs of displays, demonstrations, and exhibits;

(b) Costs of meeting rooms, hospitality suites, and other special facilities used in conjunction with shows and other special events; and

(c) Salaries and wages of employees engaged in setting up and displaying exhibits, making demonstrations, and providing briefings;

(3) Costs of promotional items and memorabilia, including models, gifts, and souvenirs;

(4) Costs of advertising and public relations designed solely to promote the non-profit organization.

2. Advisory Councils. Costs incurred by advisory councils or committees are allowable as a direct cost where authorized by the Federal awarding agency or as an indirect cost where allocable to Federal awards.

3. Alcoholic beverages. Costs of alcoholic beverages are unallowable.

4. Audit costs and related services.

a. The costs of audits required by, and performed in accordance with, the Single Audit Act, as implemented by Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations" are allowable. Also see 31 U.S.C. 7505(b) and section 230 ("Audit Costs") of Circular A-133.

b. Other audit costs are allowable if included in an indirect cost rate proposal, or if specifically approved by the awarding agency as a direct cost to an award.

c. The cost of agreed-upon procedures engagements to monitor subrecipients who are exempted from A-133 under section 200(d) are allowable, subject to the conditions listed in A-133, section 230 (b)(2).

5. Bad debts. Bad debts, including losses (whether actual or estimated) arising from uncollectible accounts and other claims, related collection costs, and related legal costs, are unallowable.

6. Bonding costs.

a. Bonding costs arise when the Federal Government requires assurance against financial loss to itself or others by reason of the act or default of the non-profit organization. They arise also in instances where the non-profit organization requires similar assurance. Included are such bonds as bid, performance, payment, advance payment, infringement, and fidelity bonds.

b. Costs of bonding required pursuant to the terms of the award are allowable.

c. Costs of bonding required by the non-profit organization in the general conduct of its operations are allowable to the extent that such bonding is in accordance with sound business practice and the rates and premiums are reasonable under the circumstances.

7. Communication costs. Costs incurred for telephone services, local and long distance telephone calls, telegrams, postage, messenger, electronic or computer transmittal services and the like are allowable.⁴³

8. Compensation for personal services⁴⁴.

a. Definition. Compensation for personal services includes all compensation paid currently or accrued by the organization for services of employees rendered during the period of the award (except as otherwise provided in subparagraph 8.h of this appendix). It includes, but is not limited to, salaries, wages, director's and executive committee member's fees, incentive awards, fringe benefits, pension plan costs, allowances for off-site pay, incentive pay, location allowances, hardship pay, and cost of living differentials.

b. Allowability. Except as otherwise specifically provided in this paragraph, the costs of such compensation are allowable to the extent that:

(1) Total compensation to individual employees is reasonable for the services rendered and conforms to the established policy of the organization consistently applied to both Federal and non-Federal activities; and

(2) Charges to awards whether treated as direct or indirect costs are determined and supported as required in this paragraph.

c. Reasonableness. (1) When the organization is predominantly engaged in activities other than those sponsored by the Federal Government, compensation for employees on federally-sponsored work will be considered reasonable to the extent that it is consistent with that paid for similar work in the organization's other activities.

(2) When the organization is predominantly engaged in federally-sponsored activities and in cases where the kind of employees required for the Federal activities are not found in the organization's other activities, compensation for employees on federally-sponsored work will be considered reasonable to the extent that it is comparable to that paid for similar work in the labor markets in which the organization competes for the kind of employees involved.

43. Communication costs can be construed to include Internet and network infrastructure costs. This is especially true as phone systems change over to VOIP (Voice over Internet Protocol) and voice communications are just another function of your IT department.

Many of these communication costs function as shared costs – for example, core local telephone service. Each organization must determine when it is cost effective to track the use of communication services to determine the direct benefit to each cost center (for example using codes on a postage meter to determine which cost center utilized the postage). However, even with tracking, some communications costs will need to be allocated – for example, the cost of mailing checks to vendors is an administrative function which provides benefit to multiple cost centers. While it is possible to associate postage with specific checks, some payments will have been charged to multiple awards – each organization must determine whether it is reasonable and cost effective to allocate the cost of mailing a single payment or whether a method of estimation would be more effective.

44. See PARs Toolkit for important guidance on substantiating charges for personnel costs.

d. Special considerations in determining allowability. Certain conditions require special consideration and possible limitations in determining costs under Federal awards where amounts or types of compensation appear unreasonable. Among such conditions are the following:

(1) Compensation to members of non-profit organizations, trustees, directors, associates, officers, or the immediate families thereof. Determination should be made that such compensation is reasonable for the actual personal services rendered rather than a distribution of earnings in excess of costs.

(2) Any change in an organization's compensation policy resulting in a substantial increase in the organization's level of compensation, particularly when it was concurrent with an increase in the ratio of Federal awards to other activities of the organization or any change in the treatment of allowability of specific types of compensation due to changes in Federal policy.

e. Unallowable costs. Costs which are unallowable under other paragraphs of this appendix shall not be allowable under this paragraph solely on the basis that they constitute personal compensation.

f. Overtime, extra-pay shift, and multi-shift premiums. Premiums for overtime, extra-pay shifts, and multi-shift work are allowable only with the prior approval of the awarding agency except:

(1) When necessary to cope with emergencies, such as those resulting from accidents, natural disasters, breakdowns of equipment, or occasional operational bottlenecks of a sporadic nature.

(2) When employees are performing indirect functions, such as administration, maintenance, or accounting.

(3) In the performance of tests, laboratory procedures, or other similar operations which are continuous in nature and cannot reasonably be interrupted or otherwise completed.

(4) When lower overall cost to the Federal Government will result.

g. Fringe benefits.⁴⁵ (1) Fringe benefits in the form of regular compensation paid to employees during periods of authorized absences from the job, such as vacation leave, sick leave, military leave, and the like, are allowable, provided such costs are absorbed by all organization activities in proportion to the relative amount of time or effort actually devoted to each.

45. See PARs Toolkit.

(2) Fringe benefits in the form of employer contributions or expenses for social security, employee insurance, workmen's compensation insurance, pension plan costs (see subparagraph 8.h of this appendix), and the like, are allowable, provided such benefits are granted in accordance with established written organization policies. Such benefits whether treated as indirect costs or as direct costs, shall be 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.

(3)(a) Provisions for a reserve under a self-insurance program for unemployment compensation or workers' compensation are allowable to the extent that the provisions represent reasonable estimates of the liabilities for such compensation, and the types of coverage, extent of coverage, and rates and premiums would have been allowable had insurance been purchased to cover the risks. However, provisions for self-insured liabilities which do not become payable for more than one year after the provision is made shall not exceed the present value of the liability.

(b) Where an organization follows a consistent policy of expensing actual payments to, or on behalf of, employees or former employees for unemployment compensation or workers' compensation, such payments are allowable in the year of payment with the prior approval of the awarding agency, provided they are allocated to all activities of the organization.

(4) Costs of insurance on the lives of trustees, officers, or other employees holding positions of similar responsibility are allowable only to the extent that the insurance represents additional compensation. The costs of such insurance when the organization is named as beneficiary are unallowable.

h. Organization-furnished automobiles. That portion of the cost of organization-furnished automobiles that relates to personal use by employees (including transportation to and from work) is unallowable as fringe benefit or indirect costs regardless of whether the cost is reported as taxable income to the employees. These costs are allowable as direct costs to sponsored award when necessary for the performance of the sponsored award and approved by awarding agencies.

i. Pension plan costs.⁴⁶ (1) Costs of the organization's pension plan which are incurred in accordance with the established policies of the organization are allowable, provided:

46. See PARs Toolkit.

(a) Such policies meet the test of reasonableness;

(b) The methods of cost allocation are not discriminatory;

(c) The cost assigned to each fiscal year is determined in accordance with generally accepted accounting principles (GAAP), as prescribed in Accounting Principles Board Opinion No. 8 issued by the American Institute of Certified Public Accountants; and

(d) The costs assigned to a given fiscal year are funded for all plan participants within six months after the end of that year. However, increases to normal and past service pension costs caused by a delay in funding the actuarial liability beyond 30 days after each quarter of the year to which such costs are assignable are unallowable.

(2) Pension plan termination insurance premiums paid pursuant to the Employee Retirement Income Security Act (ERISA) of 1974 (Pub. L. 93–406) are allowable. Late payment charges on such premiums are unallowable.

(3) Excise taxes on accumulated funding deficiencies and other penalties imposed under ERISA are unallowable.

j. Incentive compensation. Incentive compensation to employees based on cost reduction, or efficient performance, suggestion awards, safety awards, etc., are allowable to the extent that the overall compensation is determined to be reasonable and such costs are paid or accrued pursuant to an agreement entered into in good faith between the organization and the employees before the services were rendered, or pursuant to an established plan followed by the organization so consistently as to imply, in effect, an agreement to make such payment.

k. Severance pay. (1) Severance pay, also commonly referred to as dismissal wages, is a payment in addition to regular salaries and wages, by organizations to workers whose employment is being terminated. Costs of severance pay are allowable only to the extent that in each case, it is required by:

(a) Law

(b) Employer-employee agreement

(c) Established policy that constitutes, in effect, an implied agreement on the organization's part, or

(d) Circumstances of the particular employment.

(2) Costs of severance payments are divided into two categories as follows:

(a) Actual normal turnover severance payments shall be allocated to all activities; or, where the organization provides for a reserve for normal severances, such method will be acceptable if the charge to current operations is reasonable in light of payments actually made for normal severances over a representative past period, and if amounts charged are allocated to all activities of the organization.

(b) Abnormal or mass severance pay is of such a conjectural nature that measurement of costs by means of an accrual will not achieve equity to both parties. Thus, accruals for this purpose are not allowable. However, the Federal Government recognizes its obligation to participate, to the extent of its fair share, in any specific payment. Thus, allowability will be considered on a case-by-case basis in the event or occurrence.

(c) Costs incurred in certain severance pay packages (commonly known as “a golden parachute” payment) which are in an amount in excess of the normal severance pay paid by the organization to an employee upon termination of employment and are paid to the employee contingent upon a change in management control over, or ownership of, the organization's assets are unallowable.

(d) Severance payments to foreign nationals employed by the organization outside the United States, to the extent that the amount exceeds the customary or prevailing practices for the organization in the United States are unallowable, unless they are necessary for the performance of Federal programs and approved by awarding agencies.

(e) Severance payments to foreign nationals employed by the organization outside the United States due to the termination of the foreign national as a result of the closing of, or curtailment of activities by, the organization in that country, are unallowable, unless they are necessary for the performance of Federal programs and approved by awarding agencies.

l. Training costs. See paragraph 49 of this appendix.

m. Support of salaries and wages.

(1) Charges to awards for salaries and wages, whether treated as direct costs or indirect costs, will be based on documented payrolls approved by a responsible official(s) of the organization. The distribution of salaries and wages to awards must be supported by personnel activity reports, as prescribed in subparagraph 8.m.(2) of this appendix, except when a substitute system has been approved in writing by the cognizant agency. (See subparagraph E.2 of Appendix A to this part.)

(2) Reports reflecting the distribution of activity of each employee must be maintained for all staff members (professionals and nonprofessionals) whose compensation is charged, in whole or in part, directly to awards. In addition, in order to support the allocation of indirect costs, such reports must also be maintained for other employees whose work involves two or more functions or activities if a distribution of their compensation between such functions or activities is needed in the determination of the organization's indirect cost rate(s) (e.g. , an employee engaged part-time in indirect cost activities and part-time in a direct function). Reports maintained by non-profit organizations to satisfy these requirements must meet the following standards:

(a) The reports must reflect an after-the-fact determination of the actual activity of each employee. Budget estimates (i.e. , estimates determined before the services are performed) do not qualify as support for charges to awards.

(b) Each report must account for the total activity for which employees are compensated and which is required in fulfillment of their obligations to the organization.

(c) The reports must be signed by the individual employee, or by a responsible supervisory official having first hand knowledge of the activities performed by the employee, that the distribution of activity represents a reasonable estimate of the actual work performed by the employee during the periods covered by the reports.

(d) The reports must be prepared at least monthly and must coincide with one or more pay periods.

(3) Charges for the salaries and wages of nonprofessional employees, in addition to the supporting documentation described in subparagraphs (1) and (2), must also be supported by records indicating the total number of hours worked each day maintained in conformance with Department of Labor regulations implementing the Fair Labor Standards Act (FLSA) (29 CFR part 516). For this purpose, the term “nonprofessional employee” shall have the same meaning as “nonexempt employee,” under FLSA.

(4) Salaries and wages of employees used in meeting cost sharing or matching requirements on awards must be supported in the same manner as salaries and wages claimed for reimbursement from awarding agencies.

9. Contingency provisions. Contributions to a contingency reserve or any similar provision made for events the occurrence of which cannot be foretold with certainty as to time, intensity, or with an assurance of their happening, are unallowable. The term “contingency reserve” excludes self-insurance reserves (see Appendix B to this part, paragraphs 8.g.(3) and 22.a(2)(d)); pension funds (see paragraph 8.i): and reserves for normal severance pay (see paragraph 8.k.)

10. Defense and prosecution of criminal and civil proceedings, claims, appeals and patent infringement.

a. Definitions. (1) Conviction, as used herein, means a judgment or a conviction of a criminal offense by any court of competent jurisdiction, whether entered upon as a verdict or a plea, including a conviction due to a plea of nolo contendere.

(2) Costs include, but are not limited to, administrative and clerical expenses; the cost of legal services, whether performed by in-house or private counsel; and the costs of the services of accountants, consultants, or others retained by the organization to assist it; costs of employees, officers and trustees, and any similar costs incurred before, during, and after commencement of a judicial or administrative proceeding that bears a direct relationship to the proceedings.

(3) Fraud, as used herein, means acts of fraud corruption or attempts to defraud the Federal Government or to corrupt its agents, acts that constitute a cause for debarment or suspension (as specified in agency regulations), and acts which violate the False Claims Act, 31 U.S.C., sections 3729–3731, or the Anti-Kickback Act, 41 U.S.C., sections 51 and 54.

(4) Penalty does not include restitution, reimbursement, or compensatory damages.

(5) Proceeding includes an investigation.

b. (1) Except as otherwise described herein, costs incurred in connection with any criminal, civil or administrative proceeding (including filing of a false certification) commenced by the Federal Government, or a State, local or foreign government, are not allowable if the proceeding: Relates to a violation of, or failure to comply with, a Federal, State, local or foreign statute or regulation

by the organization (including its agents and employees), and results in any of the following dispositions:

- (a) In a criminal proceeding, a conviction.
 - (b) In a civil or administrative proceeding involving an allegation of fraud or similar misconduct, a determination of organizational liability.
 - (c) In the case of any civil or administrative proceeding, the imposition of a monetary penalty.
 - (d) A final decision by an appropriate Federal official to debar or suspend the organization, to rescind or void an award, or to terminate an award for default by reason of a violation or failure to comply with a law or regulation.
 - (e) A disposition by consent or compromise, if the action could have resulted in any of the dispositions described in subparagraphs 10.b.(1)(a), (b), (c) or (d) of this appendix.
- (2) If more than one proceeding involves the same alleged misconduct, the costs of all such proceedings shall be unallowable if any one of them results in one of the dispositions shown in subparagraph 10.b.(1) of this appendix.
- c. If a proceeding referred to in subparagraph 10.b of this appendix is commenced by the Federal Government and is resolved by consent or compromise pursuant to an agreement entered into by the organization and the Federal Government, then the costs incurred by the organization in connection with such proceedings that are otherwise not allowable under subparagraph 10.b of this appendix may be allowed to the extent specifically provided in such agreement.
- d. If a proceeding referred to in subparagraph 10.b of this appendix is commenced by a State, local or foreign government, the authorized Federal official may allow the costs incurred by the organization for such proceedings, if such authorized official determines that the costs were incurred as a result of a specific term or condition of a federally-sponsored award, or specific written direction of an authorized official of the sponsoring agency.
- e. Costs incurred in connection with proceedings described in subparagraph 10.b of this appendix, but which are not made unallowable by that subparagraph, may be allowed by the Federal Government, but only to the extent that:
- (1) The costs are reasonable in relation to the activities required to deal with the proceeding and the underlying cause of action;
 - (2) Payment of the costs incurred, as allowable and allocable costs, is not prohibited by any other provision(s) of the sponsored award;
 - (3) The costs are not otherwise recovered from the Federal Government or a third party, either directly as a result of the proceeding or otherwise; and,

(4) The percentage of costs allowed does not exceed the percentage determined by an authorized Federal official to be appropriate, considering the complexity of the litigation, generally accepted principles governing the award of legal fees in civil actions involving the United States as a party, and such other factors as may be appropriate. Such percentage shall not exceed 80 percent. However, if an agreement reached under subparagraph 10.c of this appendix has explicitly considered this 80 percent limitation and permitted a higher percentage, then the full amount of costs resulting from that agreement shall be allowable.

f. Costs incurred by the organization in connection with the defense of suits brought by its employees or ex-employees under section 2 of the Major Fraud Act of 1988 (Pub. L. 100–700), including the cost of all relief necessary to make such employee whole, where the organization was found liable or settled, are unallowable.

g. Costs of legal, accounting, and consultant services, and related costs, incurred in connection with defense against Federal Government claims or appeals, antitrust suits, or the prosecution of claims or appeals against the Federal Government, are unallowable.

h. Costs of legal, accounting, and consultant services, and related costs, incurred in connection with patent infringement litigation, are unallowable unless otherwise provided for in the sponsored awards.

i. Costs which may be unallowable under this paragraph, including directly associated costs, shall be segregated and accounted for by the organization separately. During the pendency of any proceeding covered by subparagraphs 10.b and f of this appendix, the Federal Government shall generally withhold payment of such costs. However, if in the best interests of the Federal Government, the Federal Government may provide for conditional payment upon provision of adequate security, or other adequate assurance, and agreements by the organization to repay all unallowable costs, plus interest, if the costs are subsequently determined to be unallowable.

11. Depreciation and use allowances.⁴⁷

a. Compensation for the use of buildings, other capital improvements, and equipment on hand may be made through use allowance or depreciation. However, except as provided in paragraph 11.f of this appendix, a combination of the two methods may not be used in connection with a single class of fixed assets (e.g. , buildings, office equipment, computer equipment, etc.).

b. The computation of use allowances or depreciation shall be based on the acquisition cost of the assets involved. The acquisition cost of an asset donated to the non-profit organization by a third party shall be its fair market value at the time of the donation.

47. If facilities provide benefit to more than one cost center/ cost objective, depreciation or use allowances must be allocated using a method which fairly estimates the relative benefit provided to each cost center. In most cases, the percentage of square feet utilized by each cost center will be the most reasonable allocation method. Care is needed to be sure that measurements of the underlying use of space are up-to-date and accurate.

c. The computation of use allowances or depreciation will exclude:

(1) The cost of land;

(2) Any portion of the cost of buildings and equipment borne by or donated by the Federal Government irrespective of where title was originally vested or where it presently resides; and

(3) Any portion of the cost of buildings and equipment contributed by or for the non-profit organization in satisfaction of a statutory matching requirement.

d. General criteria where depreciation method is followed:

(1) The period of useful service (useful life) established in each case for usable capital assets must take into consideration such factors as type of construction, nature of the equipment used, technological developments in the particular program area, and the renewal and replacement policies followed for the individual items or classes of assets involved. The method of depreciation used to assign the cost of an asset (or group of assets) to accounting periods shall reflect the pattern of consumption of the asset during its useful life.

(2) In the absence of clear evidence indicating that the expected consumption of the asset will be significantly greater or lesser in the early portions of its useful life than in the later portions, the straight-line method shall be presumed to be the appropriate method.

(3) Depreciation methods once used shall not be changed unless approved in advance by the cognizant Federal agency. When the depreciation method is introduced for application to assets previously subject to a use allowance, the combination of use allowances and depreciation applicable to such assets must not exceed the total acquisition cost of the assets.

e. When the depreciation method is used for buildings, a building's shell may be segregated from each building component (e.g. , plumbing system, heating, and air conditioning system, etc.) and each item depreciated over its estimated useful life; or the entire building (i.e. , the shell and all components) may be treated as a single asset and depreciated over a single useful life.

f. When the depreciation method is used for a particular class of assets, no depreciation may be allowed on any such assets that, under subparagraph 11.d of this appendix, would be viewed as fully depreciated. However, a reasonable use allowance may be negotiated for such assets if warranted after taking into consideration the amount of depreciation previously charged to the Federal Government, the estimated useful life remaining at time of negotiation, the effect of any increased maintenance charges or decreased efficiency due to age, and any other factors pertinent to the utilization of the asset for the purpose contemplated.

g. Criteria where the use allowance method is followed:

(1) The use allowance for buildings and improvement (including land improvements, such as paved parking areas, fences, and sidewalks) will be computed at an annual rate not exceeding two percent of acquisition cost.

(2) The use allowance for equipment will be computed at an annual rate not exceeding six and two-thirds percent of acquisition cost. When the use allowance method is used for buildings, the entire building must be treated as a single asset; the building's components (e.g. , plumbing system, heating and air conditioning, etc.) cannot be segregated from the building's shell.

(3) The two percent limitation, however, need not be applied to equipment which is merely attached or fastened to the building but not permanently fixed to it and which is used as furnishings or decorations or for specialized purposes (e.g. , dentist chairs and dental treatment units, counters, laboratory benches bolted to the floor, dishwashers, modular furniture, carpeting, etc.). Such equipment will be considered as not being permanently fixed to the building if it can be removed without the need for costly or extensive alterations or repairs to the building or the equipment. Equipment that meets these criteria will be subject to the 62/3percent equipment use allowance limitation.

h. Charges for use allowances or depreciation must be supported by adequate property records and physical inventories must be taken at least once every two years (a statistical sampling basis is acceptable) to ensure that assets exist and are usable and needed. When the depreciation method is followed, adequate depreciation records indicating the amount of depreciation taken each period must also be maintained.

12. Donations and contributions.

a. Contributions or donations rendered. Contributions or donations, including cash, property, and services, made by the organization, regardless of the recipient, are unallowable.

b. Donated services received:

(1) Donated or volunteer services may be furnished to an organization by professional and technical personnel, consultants, and other skilled and unskilled labor. The value of these services is not reimbursable either as a direct or indirect cost. However, the value of donated services may be used to meet cost sharing or matching requirements in accordance with the Common Rule.

(2) The value of donated services utilized in the performance of a direct cost activity shall, when material in amount, be considered in the determination of the non-profit organization's indirect costs or rate(s) and, accordingly, shall be allocated a proportionate share of applicable indirect costs when the following exist:⁴⁸

(a) The aggregate value of the services is material;

48. This section addresses requirements for computation of a negotiated indirect cost rate. Because such rates are based on the percentage of dollars expended for various cost objectives (either total direct dollars or compensation dollars) the value of donated goods and services could POTENTIALLY impact the distribution of indirect costs. However, for most organizations without indirect cost rates, the cost allocation methods used to estimate the benefit received by various cost centers from shared costs involve either the percentage of staff time or percentage of square feet utilized in common use facilities. In these approaches the value of donated goods and services would not impact the estimated benefit received by each cost center.

(b) The services are supported by a significant amount of the indirect costs incurred by the non-profit organization; and

(c) The direct cost activity is not pursued primarily for the benefit of the Federal Government.

(3) In those instances where there is no basis for determining the fair market value of the services rendered, the recipient and the cognizant agency shall negotiate an appropriate allocation of indirect cost to the services.

(4) Where donated services directly benefit a project supported by an award, the indirect costs allocated to the services will be considered as a part of the total costs of the project. Such indirect costs may be reimbursed under the award or used to meet cost sharing or matching requirements.

(5) The value of the donated services may be used to meet cost sharing or matching requirements under conditions described in Section 215.23 of 2 CFR part 215 (OMB Circular A-110). Where donated services are treated as indirect costs, indirect cost rates will separate the value of the donations so that reimbursement will not be made.

c. Donated goods or space. (1) Donated goods; i.e., expendable personal property/supplies, and donated use of space may be furnished to a non-profit organization. The value of the goods and space is not reimbursable either as a direct or indirect cost.

(2) The value of the donations may be used to meet cost sharing or matching share requirements under the conditions described in 2 CFR part 215 (OMB Circular A-110). Where donations are treated as indirect costs, indirect cost rates will separate the value of the donations so that reimbursement will not be made.

13. Employee morale, health, and welfare costs.⁴⁹

a. The costs of employee information publications, health or first-aid clinics and/or infirmaries, recreational activities, employee counseling services, and any other expenses incurred in accordance with the non-profit organization's established practice or custom for the improvement of working conditions, employer-employee relations, employee morale, and employee performance are allowable.

b. Such costs will be equitably apportioned to all activities of the non-profit organization. Income generated from any of these activities will be credited to the cost thereof unless such income has been irrevocably set over to employee welfare organizations.

49. Most cost allocation plans will base allocation of these costs on the percentage of staff effort associated with each cost center. See PARs Toolkit for info on documenting personnel costs.

14. Entertainment costs. Costs of entertainment, including amusement, diversion, and social activities and any costs directly associated with such costs (such as tickets to shows or sports events, meals, lodging, rentals, transportation, and gratuities) are unallowable.

15. Equipment and other capital expenditures.

a. For purposes of this subparagraph, the following definitions apply:

(1) “Capital Expenditures” means expenditures for the acquisition cost of capital assets (equipment, buildings, land), or expenditures to make improvements to capital assets that materially increase their value or useful life. Acquisition cost means the cost of the asset including the cost to put it in place. Acquisition cost for equipment, for example, means the net invoice price of the equipment, including the cost of any modifications, attachments, accessories, or auxiliary apparatus necessary to make it usable for the purpose for which it is acquired. Ancillary charges, such as taxes, duty, protective in transit insurance, freight, and installation may be included in, or excluded from the acquisition cost in accordance with the non-profit organization's regular accounting practices.

(2) “Equipment” means an article of nonexpendable, tangible personal property having a useful life of more than one year and an acquisition cost which equals or exceeds the lesser of the capitalization level established by the non-profit organization for financial statement purposes, or \$5000.

(3) “Special purpose equipment” means equipment which is used only for research, medical, scientific, or other technical activities. Examples of special purpose equipment include microscopes, x-ray machines, surgical instruments, and spectrometers.

(4) “General purpose equipment” means equipment, which is not limited to research, medical, scientific or other technical activities. Examples include office equipment and furnishings, modular offices, telephone networks, information technology equipment and systems, air conditioning equipment, reproduction and printing equipment, and motor vehicles.

b. The following rules of allowability shall apply to equipment and other capital expenditures:

(1) Capital expenditures for general purpose equipment, buildings, and land are unallowable as direct charges, except where approved in advance by the awarding agency.

(2) Capital expenditures for special purpose equipment are allowable as direct costs, provided that items with a unit cost of \$5000 or more have the prior approval of the awarding agency.

(3) Capital expenditures for improvements to land, buildings, or equipment which materially increase their value or useful life are unallowable as a direct cost except with the prior approval of the awarding agency.

(4) When approved as a direct charge pursuant to paragraph 15.b.(1), (2), and (3) above, capital expenditures will be charged in the period in which the expenditure is incurred, or as otherwise determined appropriate by and negotiated with the awarding agency.

(5) Equipment and other capital expenditures are unallowable as indirect costs. However, see paragraph 11., Depreciation and use allowance, of this appendix for rules on the allowability of

use allowances or depreciation on buildings, capital improvements, and equipment. Also, see paragraph 43., Rental costs of buildings and equipment, of this appendix for rules on the allowability of rental costs for land, buildings, and equipment.

(6) The unamortized portion of any equipment written off as a result of a change in capitalization levels may be recovered by continuing to claim the otherwise allowable use allowances or depreciation on the equipment, or by amortizing the amount to be written off over a period of years negotiated with the cognizant agency.

16. Fines and penalties. Costs of fines and penalties resulting from violations of, or failure of the organization to comply with Federal, State, and local laws and regulations are unallowable except when incurred as a result of compliance with specific provisions of an award or instructions in writing from the awarding agency.

17. Fund raising⁵⁰ and investment management costs.

a. Costs of organized fund raising, including financial campaigns, endowment drives, solicitation of gifts and bequests, and similar expenses incurred solely to raise capital or obtain contributions are unallowable.

b. Costs of investment counsel and staff and similar expenses incurred solely to enhance income from investments are unallowable.

c. Fund raising and investment activities shall be allocated an appropriate share of indirect costs under the conditions described in subparagraph B.3 of Appendix A to this part.⁵¹

18. Gains and losses on depreciable assets.⁵²

a. (1) Gains and losses on sale, retirement, or other disposition of depreciable property shall be included in the year in which they occur as credits or charges to cost grouping(s) in which the depreciation applicable to such property was included. The amount of the gain or loss to be included as a credit or charge to the appropriate cost grouping(s) shall be the difference between the amount realized on the property and the undepreciated basis of the property.

(2) Gains and losses on the disposition of depreciable property shall not be recognized as a separate credit or charge under the following conditions:

50. In general, costs for organized fund raising, including financial campaigns, endowment drives, solicitation of gifts or bequests, and similar expenses incurred solely to raise capital or obtain contributions are unallowable under A-122. See paragraph 17. A-122 does not address writing or submitting proposals, and such costs are not prohibited under A-122 and HHS regulations specifically permit bid and proposal costs as allowable costs. See 45 CFR 74.27(b)(1).

51. Note: if your CAA has a fund raising function which is funded with non-federal funds, your cost allocation plan should document your compliance with the requirement to share costs fairly among all cost centers (functions) that benefit from the cost. Consequently, the space utilized by employees performing fund raising functions must be considered in calculation of the allocation of facilities costs in cost allocation plans which allocate facilities costs based on percentage of square feet utilized.

52. May require allocation if depreciation of the property has been being allocated.

- (a) The gain or loss is processed through a depreciation account and is reflected in the depreciation allowable under paragraph 11 of this appendix.
- (b) The property is given in exchange as part of the purchase price of a similar item and the gain or loss is taken into account in determining the depreciation cost basis of the new item.
- (c) A loss results from the failure to maintain permissible insurance, except as otherwise provided in paragraph 22 of this appendix.
- (d) Compensation for the use of the property was provided through use allowances in lieu of depreciation in accordance with paragraph 9 of this appendix.
- (e) Gains and losses arising from mass or extraordinary sales, retirements, or other dispositions shall be considered on a case-by-case basis.

b. Gains or losses of any nature arising from the sale or exchange of property other than the property covered in subparagraph a shall be excluded in computing award costs.

19. Goods or services for personal use. Costs of goods or services for personal use of the organization's employees are unallowable regardless of whether the cost is reported as taxable income to the employees.

20. Housing and personal living expenses.

a. Costs of housing (e.g. , depreciation, maintenance, utilities, furnishings, rent, etc.), housing allowances and personal living expenses for/of the organization's officers are unallowable as fringe benefit or indirect costs regardless of whether the cost is reported as taxable income to the employees. These costs are allowable as direct costs to sponsored award when necessary for the performance of the sponsored award and approved by awarding agencies.

b. The term “officers” includes current and past officers and employees.

21. Idle facilities and idle capacity.

a. As used in this section the following terms have the meanings set forth below:

(1) “Facilities” means land and buildings or any portion thereof, equipment individually or collectively, or any other tangible capital asset, wherever located, and whether owned or leased by the non-profit organization.

(2) “Idle facilities” means completely unused facilities that are excess to the non-profit organization's current needs.

(3) “Idle capacity” means the unused capacity of partially used facilities. It is the difference between: That which a facility could achieve under 100 percent operating time on a one-shift basis less operating interruptions resulting from time lost for repairs, setups, unsatisfactory materials, and other normal delays; and the extent to which the facility was actually used to meet demands during the accounting period. A multi-shift basis should be used if it can be shown that this amount of usage would normally be expected for the type of facility involved.

(4) “Cost of idle facilities or idle capacity” means costs such as maintenance, repair, housing, rent, and other related costs, e.g. , insurance, interest, property taxes and depreciation or use allowances.

b. The costs of idle facilities are unallowable except to the extent that:

(1) They are necessary to meet fluctuations in workload; or

(2) Although not necessary to meet fluctuations in workload, they were necessary when acquired and are now idle because of changes in program requirements, efforts to achieve more economical operations, reorganization, termination, or other causes which could not have been reasonably foreseen. Under the exception stated in this subparagraph, costs of idle facilities are allowable for a reasonable period of time, ordinarily not to exceed one year, depending on the initiative taken to use, lease, or dispose of such facilities.

c. The costs of idle capacity are normal costs of doing business and are a factor in the normal fluctuations of usage or indirect cost rates from period to period. Such costs are allowable, provided that the capacity is reasonably anticipated to be necessary or was originally reasonable and is not subject to reduction or elimination by use on other Federal awards, subletting, renting, or sale, in accordance with sound business, economic, or security practices. Widespread idle capacity throughout an entire facility or among a group of assets having substantially the same function may be considered idle facilities.⁵³

22. Insurance and indemnification.⁵⁴

a. Insurance includes insurance which the organization is required to carry, or which is approved, under the terms of the award and any other insurance which the organization maintains in connection with the general conduct of its operations. This paragraph does not apply to insurance which represents fringe benefits for employees (see subparagraphs 8.g and 8.i(2) of this appendix).

53. This provision could apply to facilities intended for use in performance of administrative functions and consequently allocation of allowable associated costs would be accomplished utilizing the cost allocation methods described in the cost allocation plan for similar types of facilities.

54. While certain insurance costs may be directly attributable to and charged to specific cost centers (for example, insurance for errors and omissions in caring for children in a Head Start program), other insurance costs provide benefit to multiple cost centers and must be allocated through reasonable cost allocation methods. For such shared cost insurance expenses, select the allocation method which most closely parallels the nature of the benefit received. For example, Directors and Officers errors and Omissions insurance is an administrative cost. Vehicle liability insurance may be associated with the number of employees permitted to drive agency vehicles (or permitted to use their own vehicles for agency business in the case of non-owned vehicle liability coverage). Cost allocation methods for such coverage could be based on either the percentage of total covered employees reporting time devoted to each cost center.

(1) Costs of insurance required or approved, and maintained, pursuant to the award are allowable.

(2) Costs of other insurance maintained by the organization in connection with the general conduct of its operations are allowable subject to the following limitations:

(a) Types and extent of coverage shall be in accordance with sound business practice and the rates and premiums shall be reasonable under the circumstances.

(b) Costs allowed for business interruption or other similar insurance shall be limited to exclude coverage of management fees.

(c) Costs of insurance or of any provisions for a reserve covering the risk of loss or damage to Federal property are allowable only to the extent that the organization is liable for such loss or damage.

(d) Provisions for a reserve under a self-insurance program are allowable to the extent that types of coverage, extent of coverage, rates, and premiums would have been allowed had insurance been purchased to cover the risks. However, provision for known or reasonably estimated self-insured liabilities, which do not become payable for more than one year after the provision is made, shall not exceed the present value of the liability.

(e) Costs of insurance on the lives of trustees, officers, or other employees holding positions of similar responsibilities are allowable only to the extent that the insurance represents additional compensation (see subparagraph 8.g(4) of this appendix). The cost of such insurance when the organization is identified as the beneficiary is unallowable.

(f) Insurance against defects. Costs of insurance with respect to any costs incurred to correct defects in the organization's materials or workmanship are unallowable.

(g) Medical liability (malpractice) insurance. Medical liability insurance is an allowable cost of Federal research programs only to the extent that the Federal research programs involve human subjects or training of participants in research techniques. Medical liability insurance costs shall be treated as a direct cost and shall be assigned to individual projects based on the manner in which the insurer allocates the risk to the population covered by the insurance.

(3) Actual losses which could have been covered by permissible insurance (through the purchase of insurance or a self-insurance program) are unallowable unless expressly provided for in the award, except:

(a) Costs incurred because of losses not covered under nominal deductible insurance coverage provided in keeping with sound business practice are allowable.

(b) Minor losses not covered by insurance, such as spoilage, breakage, and disappearance of supplies, which occur in the ordinary course of operations, are allowable.

b. Indemnification includes securing the organization against liabilities to third persons and any other loss or damage, not compensated by insurance or otherwise. The Federal Government is obligated to indemnify the organization only to the extent expressly provided in the award.

23. Interest.

a. Costs incurred for interest on borrowed capital, temporary use of endowment funds, or the use of the non-profit organization's own funds, however represented, are unallowable. However, interest on debt incurred after September 29, 1995 to acquire or replace capital assets (including renovations, alterations, equipment, land, and capital assets acquired through capital leases), acquired after September 29, 1995 and used in support of Federal awards is allowable, provided that:

(1) For facilities acquisitions (excluding renovations and alterations) costing over \$10 million where the Federal Government's reimbursement is expected to equal or exceed 40 percent of an asset's cost, the non-profit organization prepares, prior to the acquisition or replacement of the capital asset(s), a justification that demonstrates the need for the facility in the conduct of federally-sponsored activities. Upon request, the needs justification must be provided to the Federal agency with cost cognizance authority as a prerequisite to the continued allowability of interest on debt and depreciation related to the facility. The needs justification for the acquisition of a facility should include, at a minimum, the following:

- (a) A statement of purpose and justification for facility acquisition or replacement.
- (b) A statement as to why current facilities are not adequate.
- (c) A statement of planned future use of the facility.
- (d) A description of the financing agreement to be arranged for the facility.
- (e) A summary of the building contract with estimated cost information and statement of source and use of funds.
- (f) A schedule of planned occupancy dates.

(2) For facilities costing over \$500,000, the non-profit organization prepares, prior to the acquisition or replacement of the facility, a lease/purchase analysis in accordance with the provisions of §§215.30 through 215.37 of 2 CFR 215 (OMB Circular A-110), which shows that a financed purchase or capital lease is less costly to the organization than other leasing alternatives, on a net present value basis. Discount rates used should be equal to the non-profit organization's anticipated interest rates and should be no higher than the fair market rate available to the non-profit organization from an unrelated ("arm's length") third-party. The lease/purchase analysis shall include a comparison of the net present value of the projected total cost comparisons of both alternatives over the period the asset is expected to be used by the non-

profit organization. The cost comparisons associated with purchasing the facility shall include the estimated purchase price, anticipated operating and maintenance costs (including property taxes, if applicable) not included in the debt financing, less any estimated asset salvage value at the end of the period defined above. The cost comparison for a capital lease shall include the estimated total lease payments, any estimated bargain purchase option, operating and maintenance costs, and taxes not included in the capital leasing arrangement, less any estimated credits due under the lease at the end of the period defined above. Projected operating lease costs shall be based on the anticipated cost of leasing comparable facilities at fair market rates under rental agreements that would be renewed or reestablished over the period defined above, and any expected maintenance costs and allowable property taxes to be borne by the non-profit organization directly or as part of the lease arrangement.

(3) The actual interest cost claimed is predicated upon interest rates that are no higher than the fair market rate available to the non-profit organization from an unrelated (“arm's length”) third party.

(4) Investment earnings, including interest income, on bond or loan principal, pending payment of the construction or acquisition costs, are used to offset allowable interest cost. Arbitrage earnings reportable to the Internal Revenue Service are not required to be offset against allowable interest costs.

(5) Reimbursements are limited to the least costly alternative based on the total cost analysis required under subparagraph 23.b. of this appendix. For example, if an operating lease is determined to be less costly than purchasing through debt financing, then reimbursement is limited to the amount determined if leasing had been used. In all cases where a lease/purchase analysis is performed, Federal reimbursement shall be based upon the least expensive alternative.

(6) Non-profit organizations are also subject to the following conditions:

(a) Interest on debt incurred to finance or refinance assets acquired before or reacquired after September 29, 1995, is not allowable.

(b) Interest attributable to fully depreciated assets is unallowable.

(c) For debt arrangements over \$1 million, unless the non-profit organization makes an initial equity contribution to the asset purchase of 25 percent or more, non-profit organizations shall reduce claims for interest expense by an amount equal to imputed interest earnings on excess cash flow, which is to be calculated as follows. Annually, non-profit organizations shall prepare a cumulative (from the inception of the project) report of monthly cash flows that includes inflows and outflows, regardless of the funding source. Inflows consist of depreciation expense, amortization of capitalized construction interest, and annual interest expense. For cash flow calculations, the annual inflow figures shall be divided by the number of months in the year (usually 12) that the building is in service for monthly amounts. Outflows consist of initial equity contributions, debt principal payments (less the pro rata share attributable to the unallowable costs of land) and interest payments. Where cumulative inflows exceed cumulative outflows, interest shall be calculated on the excess inflows for that period and be treated as a reduction to

allowable interest expense. The rate of interest to be used to compute earnings on excess cash flows shall be the three month Treasury Bill closing rate as of the last business day of that month.

(d) Substantial relocation of federally-sponsored activities from a facility financed by indebtedness, the cost of which was funded in whole or part through Federal reimbursements, to another facility prior to the expiration of a period of 20 years requires notice to the Federal cognizant agency. The extent of the relocation, the amount of the Federal participation in the financing, and the depreciation and interest charged to date may require negotiation and/or downward adjustments of replacement space charged to Federal programs in the future.

(e) The allowable costs to acquire facilities and equipment are limited to a fair market value available to the non-profit organization from an unrelated (“arm's length”) third party.

b. For non-profit organizations subject to “full coverage” under the Cost Accounting Standards (CAS) as defined at 48 CFR 9903.201, the interest allowability provisions of subparagraph a do not apply. Instead, these organizations' sponsored agreements are subject to CAS 414 (48 CFR 9903.414), cost of money as an element of the cost of facilities capital, and CAS 417 (48 CFR 9903.417), cost of money as an element of the cost of capital assets under construction.

c. The following definitions are to be used for purposes of this paragraph:

(1) Re-acquired assets means assets held by the non-profit organization prior to September 29, 1995 that have again come to be held by the organization, whether through repurchase or refinancing. It does not include assets acquired to replace older assets.

(2) Initial equity contribution means the amount or value of contributions made by non-profit organizations for the acquisition of the asset or prior to occupancy of facilities.

(3) Asset costs means the capitalizable costs of an asset, including construction costs, acquisition costs, and other such costs capitalized in accordance with GAAP.

24. Labor relations costs. Costs incurred in maintaining satisfactory relations between the organization and its employees, including costs of labor management committees, employee publications, and other related activities are allowable.

25. Lobbying.⁵⁵

a. Notwithstanding other provisions of this appendix, costs associated with the following activities are unallowable:

55. See comment 51 above – same principle applies for unallowable lobbying, etc. Same as fundraising.

- (1) Attempts to influence the outcomes of any Federal, State, or local election, referendum, initiative, or similar procedure, through in kind or cash contributions, endorsements, publicity, or similar activity;
- (2) Establishing, administering, contributing to, or paying the expenses of a political party, campaign, political action committee, or other organization established for the purpose of influencing the outcomes of elections;
- (3) Any attempt to influence: The introduction of Federal or State legislation; or the enactment or modification of any pending Federal or State legislation through communication with any member or employee of the Congress or State legislature (including efforts to influence State or local officials to engage in similar lobbying activity), or with any Government official or employee in connection with a decision to sign or veto enrolled legislation;
- (4) Any attempt to influence: The introduction of Federal or State legislation; or the enactment or modification of any pending Federal or State legislation by preparing, distributing or using publicity or propaganda, or by urging members of the general public or any segment thereof to contribute to or participate in any mass demonstration, march, rally, fundraising drive, lobbying campaign or letter writing or telephone campaign; or
- (5) Legislative liaison activities, including attendance at legislative sessions or committee hearings, gathering information regarding legislation, and analyzing the effect of legislation, when such activities are carried on in support of or in knowing preparation for an effort to engage in unallowable lobbying.

b. The following activities are excepted from the coverage of subparagraph 25.a of this appendix:

- (1) Providing a technical and factual presentation of information on a topic directly related to the performance of a grant, contract or other agreement through hearing testimony, statements or letters to the Congress or a State legislature, or subdivision, member, or cognizant staff member thereof, in response to a documented request (including a Congressional Record notice requesting testimony or statements for the record at a regularly scheduled hearing) made by the recipient member, legislative body or subdivision, or a cognizant staff member thereof; provided such information is readily obtainable and can be readily put in deliverable form; and further provided that costs under this section for travel, lodging or meals are unallowable unless incurred to offer testimony at a regularly scheduled Congressional hearing pursuant to a written request for such presentation made by the Chairman or Ranking Minority Member of the Committee or Subcommittee conducting such hearing.
- (2) Any lobbying made unallowable by subparagraph 25.a.(3) of this appendix to influence State legislation in order to directly reduce the cost, or to avoid material impairment of the organization's authority to perform the grant, contract, or other agreement.
- (3) Any activity specifically authorized by statute to be undertaken with funds from the grant, contract, or other agreement.

c. (1) When an organization seeks reimbursement for indirect costs, total lobbying costs shall be separately identified in the indirect cost rate proposal, and thereafter treated as other unallowable activity costs in accordance with the procedures of subparagraph B.3 of Appendix A to this part.⁵⁶

(2) Organizations shall submit, as part of the annual indirect cost rate proposal, a certification that the requirements and standards of this paragraph have been complied with.

(3) Organizations shall maintain adequate records to demonstrate that the determination of costs as being allowable or unallowable pursuant to paragraph 25 complies with the requirements of this Appendix.

(4) Time logs,⁵⁷ calendars, or similar records shall not be required to be created for purposes of complying with this paragraph during any particular calendar month when: the employee engages in lobbying (as defined in subparagraphs 25.a. and b. of this appendix) 25 percent or less of the employee's compensated hours of employment during that calendar month, and within the preceding five-year period, the organization has not materially misstated allowable or unallowable costs of any nature, including legislative lobbying costs. When the conditions described in this subparagraph are met, organizations are not required to establish records to support the allowability of claimed costs in addition to records already required or maintained. Also, when the conditions described in this subparagraph are met, the absence of time logs, calendars, or similar records will not serve as a basis for disallowing costs by contesting estimates of lobbying time spent by employees during a calendar month.

56. All CAAs should establish a separate cost center for lobbying costs and should include documentation in their cost allocation plan that shared costs which benefit the lobbying function (such as facilities costs, administrative costs, etc.) will be allocated a fair share of such costs.

57. See PARs Toolkit.

(5) Agencies shall establish procedures for resolving in advance, in consultation with OMB, any significant questions or disagreements concerning the interpretation or application of paragraph 25. Any such advance resolution shall be binding in any subsequent settlements, audits or investigations with respect to that grant or contract for purposes of interpretation of this Appendix; provided, however, that this shall not be construed to prevent a contractor or grantee from contesting the lawfulness of such a determination.

d. Executive lobbying costs. Costs incurred in attempting to improperly influence either directly or indirectly, an employee or officer of the Executive Branch of the Federal Government to give consideration or to act regarding a sponsored agreement or a regulatory matter are unallowable. Improper influence means any influence that induces or tends to induce a Federal employee or officer to give consideration or to act regarding a federally-sponsored agreement or regulatory matter on any basis other than the merits of the matter.

26. Losses on other sponsored agreements or contracts.⁵⁸ Any excess of costs over income on any award is unallowable as a cost of any other award. This includes, but is not limited to, the organization's contributed portion by reason of cost sharing agreements or any under-recoveries through negotiation of lump sums for, or ceilings on, indirect costs.

27. Maintenance and repair costs.⁵⁹ Costs incurred for necessary maintenance, repair, or upkeep of buildings and equipment (including Federal property unless otherwise provided for) which neither add to the permanent value of the property nor appreciably prolong its intended life, but keep it in an efficient operating condition, are allowable. Costs incurred for improvements which add to the permanent value of the buildings and equipment or appreciably prolong their intended life shall be treated as capital expenditures (see paragraph 15 of this appendix).

28. Materials and supplies costs.

a. Costs incurred for materials, supplies, and fabricated parts necessary to carry out a Federal award are allowable.

b. Purchased materials and supplies shall be charged at their actual prices, net of applicable credits. Withdrawals from general stores or stockrooms should be charged at their actual net cost under any recognized method of pricing inventory withdrawals, consistently applied. Incoming transportation charges are a proper part of materials and supplies costs.

c. Only materials and supplies actually used for the performance of a Federal award may be charged as direct costs.⁶⁰

d. Where federally-donated or furnished materials are used in performing the Federal award, such materials will be used without charge.

29. Meetings and conferences.⁶¹ Costs of meetings and conferences, the primary purpose of which is the dissemination of technical information, are allowable. This includes costs of meals, transportation, rental of facilities, speakers' fees, and other items incidental to such meetings or conferences. But see paragraphs 14., Entertainment costs, and 33., Participant support costs of this appendix.

58. Another example of prohibition of shifting costs from one award to other awards.

59. Costs to maintain and repair buildings or equipment which provide benefit to more than one cost center must be allocated. Most cost allocation plans utilize the same method to allocate maintenance and repair costs as is used for space rental and utilities.

60. Cost allocation plans will need to distinguish materials and supplies which can be directly associated with specific cost centers and those which cannot readily be associated with specific cost center- the shared costs. Plans should describe the method which will be utilized to allocate shared materials and supplies costs. Maintenance supplies are often allocated following the formula for facilities costs. Office supplies are often allocated based on percentage of FTE performing work for each cost center.

61. Cost allocation plan should describe method used to allocate such costs – frequently percentage of FTE method will be utilized.

30. Memberships, subscriptions, and professional activity costs.⁶²

a. Costs of the non-profit organization's membership in business, technical, and professional organizations are allowable.

b. Costs of the non-profit organization's subscriptions to business, professional, and technical periodicals are allowable.

c. Costs of membership in any civic or community organization are allowable with prior approval by Federal cognizant agency.

d. Costs of membership in any country club or social or dining club or organization are unallowable.

31. Organization costs. Expenditures, such as incorporation fees, brokers' fees, fees to promoters, organizers or management consultants, attorneys, accountants, or investment counselors, whether or not employees of the organization, in connection with establishment or reorganization of an organization, are unallowable except with prior approval of the awarding agency.

32. Page charges in professional journals. Page charges for professional journal publications are allowable as a necessary part of research costs, where:

a. The research papers report work supported by the Federal Government; and

b. The charges are levied impartially on all research papers published by the journal, whether or not by federally-sponsored authors.

33. Participant support costs.⁶³ Participant support costs are direct costs for items such as stipends or subsistence allowances, travel allowances, and registration fees paid to or on behalf of participants or trainees (but not employees) in connection with meetings, conferences, symposia, or training projects. These costs are allowable with the prior approval of the awarding agency.

34. Patent costs.

a. The following costs relating to patent and copyright matters are allowable: cost of preparing disclosures, reports, and other documents required by the Federal award and of searching the art

62. Determine if such costs benefit only one cost objective or multiple cost objectives. Describe method for allocation for those costs providing benefit to multiple cost centers. Percentage of FTE performing work in each of the benefiting cost centers is a common allocation method for these costs.

63. CAAs operating programs in which multiple funding sources are providing funds for essentially identical services for clients meeting essentially identical eligibility requirements must establish a method for determining which participant support costs will be charged to which awards. It may be sufficient for the program staff person authorizing the support costs to indicate the program for which the cost is incurred and for accounting staff to apply an allocation methodology to determine which funding source will be charged.

to the extent necessary to make such disclosures; cost of preparing documents and any other patent costs in connection with the filing and prosecution of a United States patent application where title or royalty-free license is required by the Federal Government to be conveyed to the Federal Government; and general counseling services relating to patent and copyright matters, such as advice on patent and copyright laws, regulations, clauses, and employee agreements (but see paragraphs 37., Professional services costs, and 44., Royalties and other costs for use of patents and copyrights, of this appendix).

b. The following costs related to patent and copyright matter are unallowable:

(1) Cost of preparing disclosures, reports, and other documents and of searching the art to the extent necessary to make disclosures not required by the award.

(2) Costs in connection with filing and prosecuting any foreign patent application, or any United States patent application, where the Federal award does not require conveying title or a royalty-free license to the Federal Government (but see paragraph 45., Royalties and other costs for use of patents and copyrights, of this appendix).

35. Plant and homeland security costs.⁶⁴ Necessary and reasonable expenses incurred for routine and homeland security to protect facilities, personnel, and work products are allowable. Such costs include, but are not limited to, wages and uniforms of personnel engaged in security activities; equipment; barriers; contractual security services; consultants; etc. Capital expenditures for homeland and plant security purposes are subject to paragraph 15., Equipment and other capital expenditures, of this appendix.

36. Pre-agreement costs. Pre-award costs are those incurred prior to the effective date of the award directly pursuant to the negotiation and in anticipation of the award where such costs are necessary to comply with the proposed delivery schedule or period of performance. Such costs are allowable only to the extent that they would have been allowable if incurred after the date of the award and only with the written approval of the awarding agency.

37. Professional services costs.⁶⁵

a. Costs of professional and consultant services rendered by persons who are members of a particular profession or possess a special skill, and who are not officers or employees of the non-profit organization, are allowable, subject to subparagraphs b and c when reasonable in relation to the services rendered and when not contingent upon recovery of the costs from the Federal

64. Allocation should parallel methods used for other facilities costs.

65. When the professional services received provide benefit to multiple cost objectives, the cost allocation plan must describe the method that will be used to allocate the cost fairly to all benefiting cost objectives. To the extent feasible, contractors should be required to provide sufficient detail on their invoices to allow determination of the nature of the services provided and to identify the cost objectives that obtained direct benefit from the services. However, some professional services benefit the entire organization – for example, the annual audit. Professional service costs that are administrative in function should be allocated using the same allocation method used for personnel providing administrative functions.

Government. In addition, legal and related services are limited under paragraph 10 of this appendix.

b. In determining the allowability of costs in a particular case, no single factor or any special combination of factors is necessarily determinative. However, the following factors are relevant:

- (1) The nature and scope of the service rendered in relation to the service required.
- (2) The necessity of contracting for the service, considering the non-profit organization's capability in the particular area.
- (3) The past pattern of such costs, particularly in the years prior to Federal awards.
- (4) The impact of Federal awards on the non-profit organization's business (i.e. , what new problems have arisen).
- (5) Whether the proportion of Federal work to the non-profit organization's total business is such as to influence the non-profit organization in favor of incurring the cost, particularly where the services rendered are not of a continuing nature and have little relationship to work under Federal grants and contracts.
- (6) Whether the service can be performed more economically by direct employment rather than contracting.
- (7) The qualifications of the individual or concern rendering the service and the customary fees charged, especially on non-Federal awards.
- (8) Adequacy of the contractual agreement for the service (e.g. , description of the service, estimate of time required, rate of compensation, and termination provisions).

c. In addition to the factors in subparagraph 37.b of this appendix, retainer fees to be allowable must be supported by evidence of bona fide services available or rendered

38. Publication and printing costs.

a. Publication costs include the costs of printing (including the processes of composition, plate-making, press work, binding, and the end products produced by such processes), distribution, promotion, mailing, and general handling. Publication costs also include page charges in professional publications.

b. If these costs are not identifiable with a particular cost objective, they should be allocated as indirect costs to all benefiting activities of the non-profit organization.⁶⁶

66. Organizations without negotiated indirect rates will need to include these costs in their cost allocation plan.

c. Page charges for professional journal publications are allowable as a necessary part of research costs where:

(1) The research papers report work supported by the Federal Government: and

(2) The charges are levied impartially on all research papers published by the journal, whether or not by federally-sponsored authors.

39. Rearrangement and alteration costs.⁶⁷ Costs incurred for ordinary or normal rearrangement and alteration of facilities are allowable. Special arrangement and alteration costs incurred specifically for the project are allowable with the prior approval of the awarding agency.

40. Reconversion costs.⁶⁸ Costs incurred in the restoration or rehabilitation of the non-profit organization's facilities to approximately the same condition existing immediately prior to commencement of Federal awards, less costs related to normal wear and tear, are allowable.

41. Recruiting costs.⁶⁹

a. Subject to subparagraphs 41.b, c, and d of this appendix, and provided that the size of the staff recruited and maintained is in keeping with workload requirements, costs of “help wanted” advertising, operating costs of an employment office necessary to secure and maintain an adequate staff, costs of operating an aptitude and educational testing program, travel costs of employees while engaged in recruiting personnel, travel costs of applicants for interviews for prospective employment, and relocation costs incurred incident to recruitment of new employees, are allowable to the extent that such costs are incurred pursuant to a well-managed recruitment program. Where the organization uses employment agencies, costs that are not in excess of standard commercial rates for such services are allowable.

b. In publications, costs of help wanted advertising that includes color, includes advertising material for other than recruitment purposes, or is excessive in size (taking into consideration recruitment purposes for which intended and normal organizational practices in this respect), are unallowable.

c. Costs of help wanted advertising, special emoluments, fringe benefits, and salary allowances incurred to attract professional personnel from other organizations that do not meet the test of reasonableness or do not conform with the established practices of the organization, are unallowable.

67. Another allocable cost to be addressed in the cost allocation plan.

68. Another allocable cost to be addressed in the cost allocation plan.

69. Costs for recruiting administrative personnel, and other personnel who will provide benefit to multiple cost objectives, must be allocated fairly. In most cases, the allocation method will parallel that which will be used to allocate the cost of the position once it is filled. See PARs Toolkit.

d. Where relocation costs incurred incident to recruitment of a new employee have been allowed either as an allocable direct or indirect cost, and the newly hired employee resigns for reasons within his control within twelve months after being hired, the organization will be required to refund or credit such relocation costs to the Federal Government.

42. Relocation costs.⁷⁰

a. Relocation costs are costs incident to the permanent change of duty assignment (for an indefinite period or for a stated period of not less than 12 months) of an existing employee or upon recruitment of a new employee. Relocation costs are allowable, subject to the limitation described in subparagraphs 42.b, c, and d of this appendix, provided that:

70. Justification of allocation of relocation costs requires similar analysis as recruiting costs – must base allocation on the work which is intended to be performed by the relocated employee.

- (1) The move is for the benefit of the employer.
- (2) Reimbursement to the employee is in accordance with an established written policy consistently followed by the employer.
- (3) The reimbursement does not exceed the employee's actual (or reasonably estimated) expenses.

b. Allowable relocation costs for current employees are limited to the following:

- (1) The costs of transportation of the employee, members of his immediate family and his household, and personal effects to the new location.
- (2) The costs of finding a new home, such as advance trips by employees and spouses to locate living quarters and temporary lodging during the transition period, up to maximum period of 30 days, including advance trip time.
- (3) Closing costs, such as brokerage, legal, and appraisal fees, incident to the disposition of the employee's former home. These costs, together with those described in subparagraph 42.b.(4) of this appendix, are limited to 8 percent of the sales price of the employee's former home.
- (4) The continuing costs of ownership of the vacant former home after the settlement or lease date of the employee's new permanent home, such as maintenance of buildings and grounds (exclusive of fixing up expenses), utilities, taxes, and property insurance.
- (5) Other necessary and reasonable expenses normally incident to relocation, such as the costs of canceling an unexpired lease, disconnecting and reinstalling household appliances, and purchasing insurance against loss of or damages to personal property. The cost of canceling an unexpired lease is limited to three times the monthly rental.

c. Allowable relocation costs for new employees are limited to those described in subparagraph 42.b(1) and (2) of this appendix. When relocation costs incurred incident to the recruitment of new employees have been allowed either as a direct or indirect cost and the employee resigns for reasons within his control within 12 months after hire, the organization shall refund or credit the Federal Government for its share of the cost. However, the costs of travel to an overseas location shall be considered travel costs in accordance with paragraph 50 and not relocation costs for the purpose of this paragraph if dependents are not permitted at the location for any reason and the costs do not include costs of transporting household goods.

d. The following costs related to relocation are unallowable:

- (1) Fees and other costs associated with acquiring a new home.
- (2) A loss on the sale of a former home.
- (3) Continuing mortgage principal and interest payments on a home being sold.
- (4) Income taxes paid by an employee related to reimbursed relocation costs.

43. Rental costs of buildings and equipment.⁷¹

a. Subject to the limitations described in subparagraphs 43.b. through d. of this appendix, rental costs are allowable to the extent that the rates are reasonable in light of such factors as: Rental costs of comparable property, if any; market conditions in the area; alternatives available; and, the type, life expectancy, condition, and value of the property leased.

Rental arrangements should be reviewed periodically to determine if circumstances have changed and other options are available.

71. Rental costs for facilities benefitting multiple cost objectives must be allocated. Most common method is the percentage of square feet method.

b. Rental costs under “sale and lease back” arrangements are allowable only up to the amount that would be allowed had the non-profit organization continued to own the property. This amount would include expenses such as depreciation or use allowance, maintenance, taxes, and insurance.

c. Rental costs under “less-than-arms-length” leases are allowable only up to the amount (as explained in subparagraph 43.b. of this appendix) that would be allowed had title to the property vested in the non-profit organization. For this purpose, a less-than-arms-length lease is one under which one party to the lease agreement is able to control or substantially influence the actions of the other. Such leases include, but are not limited to those between divisions of a non-profit organization; non-profit organizations under common control through common officers, directors, or members; and a non-profit organization and a director, trustee, officer, or key employee of the non-profit organization or his immediate family, either directly or through corporations, trusts, or similar arrangements in which they hold a controlling interest. For

example, a non-profit organization may establish a separate corporation for the sole purpose of owning property and leasing it back to the non-profit organization.

d. Rental costs under leases which are required to be treated as capital leases under GAAP are allowable only up to the amount (as explained in subparagraph b) that would be allowed had the non-profit organization purchased the property on the date the lease agreement was executed. The provisions of Financial Accounting Standards Board Statement 13, Accounting for Leases, shall be used to determine whether a lease is a capital lease. Interest costs related to capital leases are allowable to the extent they meet the criteria in paragraph 23 of this appendix. Unallowable costs include amounts paid for profit, management fees, and taxes that would not have been incurred had the non-profit organization purchased the facility.

44. Royalties and other costs for use of patents and copyrights.

a. Royalties on a patent or copyright or amortization of the cost of acquiring by purchase a copyright, patent, or rights thereto, necessary for the proper performance of the award are allowable unless:

(1) The Federal Government has a license or the right to free use of the patent or copyright.

(2) The patent or copyright has been adjudicated to be invalid, or has been administratively determined to be invalid.

(3) The patent or copyright is considered to be unenforceable.

(4) The patent or copyright is expired.

b. Special care should be exercised in determining reasonableness where the royalties may have arrived at as a result of less-than-arm's-length bargaining, e.g.:

(1) Royalties paid to persons, including corporations, affiliated with the non-profit organization.

(2) Royalties paid to unaffiliated parties, including corporations, under an agreement entered into in contemplation that a Federal award would be made.

(3) Royalties paid under an agreement entered into after an award is made to a non-profit organization.

c. In any case involving a patent or copyright formerly owned by the non-profit organization, the amount of royalty allowed should not exceed the cost which would have been allowed had the non-profit organization retained title thereto.

45. Selling and marketing. Costs of selling and marketing any products or services of the non-profit organization are unallowable (unless allowed under paragraph 1. of this appendix as allowable public relations cost. However, these costs are allowable as direct costs, with prior

approval by awarding agencies, when they are necessary for the performance of Federal programs.

46. Specialized service facilities.

- a. The costs of services provided by highly complex or specialized facilities operated by the non-profit organization, such as computers, wind tunnels, and reactors are allowable, provided the charges for the services meet the conditions of either paragraph 46 b. or c. of this appendix and, in addition, take into account any items of income or Federal financing that qualify as applicable credits under subparagraph A.5. of Appendix A to this part.
- b. The costs of such services, when material, must be charged directly to applicable awards based on actual usage of the services on the basis of a schedule of rates or established methodology that does not discriminate against federally-supported activities of the non-profit organization, including usage by the non-profit organization for internal purposes, and is designed to recover only the aggregate costs of the services. The costs of each service shall consist normally of both its direct costs and its allocable share of all indirect costs. Rates shall be adjusted at least biennially, and shall take into consideration over/under applied costs of the previous period(s).
- c. Where the costs incurred for a service are not material, they may be allocated as indirect costs.
- d. Under some extraordinary circumstances, where it is in the best interest of the Federal Government and the institution to establish alternative costing arrangements, such arrangements may be worked out with the cognizant Federal agency.

72. Taxes associated with facilities costs should be allocated using methods consistent with the allocation of other facilities costs.

47. Taxes.⁷²

- a. In general, taxes which the organization is required to pay and which are paid or accrued in accordance with GAAP, and payments made to local governments in lieu of taxes which are commensurate with the local government services received are allowable, except for taxes from which exemptions are available to the organization directly or which are available to the organization based on an exemption afforded the Federal Government and in the latter case when the awarding agency makes available the necessary exemption certificates, special assessments on land which represent capital improvements, and Federal income taxes.
- b. Any refund of taxes, and any payment to the organization of interest thereon, which were allowed as award costs, will be credited either as a cost reduction or cash refund, as appropriate, to the Federal Government.

48. Termination costs applicable to sponsored agreements. Termination of awards generally gives rise to the incurrence of costs, or the need for special treatment of costs, which would not have arisen had the Federal award not been terminated. Cost principles covering these items are

set forth below. They are to be used in conjunction with the other provisions of this appendix in termination situations.

a. The cost of items reasonably usable on the non-profit organization's other work shall not be allowable unless the non-profit organization submits evidence that it would not retain such items at cost without sustaining a loss. In deciding whether such items are reasonably usable on other work of the non-profit organization, the awarding agency should consider the non-profit organization's plans and orders for current and scheduled activity. Contemporaneous purchases of common items by the non-profit organization shall be regarded as evidence that such items are reasonably usable on the non-profit organization's other work. Any acceptance of common items as allocable to the terminated portion of the Federal award shall be limited to the extent that the quantities of such items on hand, in transit, and on order are in excess of the reasonable quantitative requirements of other work.

b. If in a particular case, despite all reasonable efforts by the non-profit organization, certain costs cannot be discontinued immediately after the effective date of termination, such costs are generally allowable within the limitations set forth in this appendix, except that any such costs continuing after termination due to the negligent or willful failure of the non-profit organization to discontinue such costs shall be unallowable.

c. Loss of useful value of special tooling, machinery, and is generally allowable if:

(1) Such special tooling, special machinery, or equipment is not reasonably capable of use in the other work of the non-profit organization,

(2) The interest of the Federal Government is protected by transfer of title or by other means deemed appropriate by the awarding agency, and

(3) The loss of useful value for any one terminated Federal award is limited to that portion of the acquisition cost which bears the same ratio to the total acquisition cost as the terminated portion of the Federal award bears to the entire terminated Federal award and other Federal awards for which the special tooling, special machinery, or equipment was acquired.

d. Rental costs under unexpired leases are generally allowable where clearly shown to have been reasonably necessary for the performance of the terminated Federal award less the residual value of such leases, if:

(1) The amount of such rental claimed does not exceed the reasonable use value of the property leased for the period of the Federal award and such further period as may be reasonable, and

(2) The non-profit organization makes all reasonable efforts to terminate, assign, settle, or otherwise reduce the cost of such lease. There also may be included the cost of alterations of such leased property, provided such alterations were necessary for the performance of the Federal award, and of reasonable restoration required by the provisions of the lease.

e. Settlement expenses including the following are generally allowable:

(1) Accounting, legal, clerical, and similar costs reasonably necessary for:

(a) The preparation and presentation to the awarding agency of settlement claims and supporting data with respect to the terminated portion of the Federal award, unless the termination is for default (see §215.61 of 2 CFR part 215 (OMB Circular A-110)); and

(b) The termination and settlement of subawards.

(2) Reasonable costs for the storage, transportation, protection, and disposition of property provided by the Federal Government or acquired or produced for the Federal award, except when grantees or contractors are reimbursed for disposals at a predetermined amount in accordance with §215.32 through 215.37 of 2 CFR part 215 (OMB Circular A-110).

(3) Indirect costs related to salaries and wages incurred as settlement expenses in subparagraphs 48.e.(1) and (2) of this appendix. Normally, such indirect costs shall be limited to fringe benefits, occupancy cost, and immediate supervision.

f. Claims under sub awards, including the allocable portion of claims which are common to the Federal award, and to other work of the non-profit organization are generally allowable.

An appropriate share of the non-profit organization's indirect expense may be allocated to the amount of settlements with subcontractors and/or subgrantees, provided that the amount allocated is otherwise consistent with the basic guidelines contained in Appendix A. The indirect expense so allocated shall exclude the same and similar costs claimed directly or indirectly as settlement expenses.

49. Training costs.⁷³

a. Costs of preparation and maintenance of a program of instruction including but not limited to on-the-job, classroom, and apprenticeship training, designed to increase the vocational effectiveness of employees, including training materials, textbooks, salaries or wages of trainees (excluding overtime compensation which might arise therefrom), and (i) salaries of the director of training and staff when the training program is conducted by the organization; or (ii) tuition and fees when the training is in an institution not operated by the organization, are allowable.

b. Costs of part-time education, at an undergraduate or post-graduate college level, including that provided at the organization's own facilities, are allowable only when the course or degree pursued is relative to the field in which the employee is now working or may reasonably be expected to work, and are limited to:

(1) Training materials.

73. Costs for training of employees whose work benefits multiple cost objectives should be allocated among the benefitting cost centers. See PARs Toolkit for guidance on documenting the use of staff time to benefit multiple cost centers.

(2) Textbooks.

(3) Fees charges by the educational institution.

(4) Tuition charged by the educational institution or, in lieu of tuition, instructors' salaries and the related share of indirect costs of the educational institution to the extent that the sum thereof is not in excess of the tuition which would have been paid to the participating educational institution.

(5) Salaries and related costs of instructors who are employees of the organization.

(6) Straight-time compensation of each employee for time spent attending classes during working hours not in excess of 156 hours per year and only to the extent that circumstances do not permit the operation of classes or attendance at classes after regular working hours; otherwise, such compensation is unallowable.

c. Costs of tuition, fees, training materials, and textbooks (but not subsistence, salary, or any other emoluments) in connection with full-time education, including that provided at the organization's own facilities, at a post-graduate (but not undergraduate) college level, are allowable only when the course or degree pursued is related to the field in which the employee is now working or may reasonably be expected to work, and only where the costs receive the prior approval of the awarding agency. Such costs are limited to the costs attributable to a total period not to exceed one school year for each employee so trained. In unusual cases the period may be extended.

d. Costs of attendance of up to 16 weeks per employee per year at specialized programs specifically designed to enhance the effectiveness of executives or managers or to prepare employees for such positions are allowable. Such costs include enrollment fees, training materials, textbooks and related charges, employees' salaries, subsistence, and travel. Costs allowable under this paragraph do not include those for courses that are part of a degree-oriented curriculum, which are allowable only to the extent set forth in subparagraphs b and c.

e. Maintenance expense, and normal depreciation or fair rental, on facilities owned or leased by the organization for training purposes are allowable to the extent set forth in paragraphs 11, 27, and 50 of this appendix.

f. Contributions or donations to educational or training institutions, including the donation of facilities or other properties, and scholarships or fellowships, are unallowable.

g. Training and education costs in excess of those otherwise allowable under subparagraphs 49.b and c of this appendix may be allowed with prior approval of the awarding agency. To be considered for approval, the organization must demonstrate that such costs are consistently incurred pursuant to an established training and education program, and that the course or degree pursued is relative to the field in which the employee is now working or may reasonably be expected to work.

50. Transportation costs.⁷⁴ Transportation costs include freight, express, cartage, and postage charges relating either to goods purchased, in process, or delivered. These costs are allowable. When such costs can readily be identified with the items involved, they may be directly charged as transportation costs or added to the cost of such items (see paragraph 28 of this appendix). Where identification with the materials received cannot readily be made, transportation costs may be charged to the appropriate indirect cost accounts if the organization follows a consistent, equitable procedure in this respect.

74. Organizations without negotiated indirect cost rates may allocate shared transportation costs utilizing allowable methods included in their cost allocation plans.

51. Travel costs.⁷⁵

a. General. Travel costs are the expenses for transportation, lodging, subsistence, and related items incurred by employees who are in travel status on official business of the non-profit organization. Such costs may be charged on an actual cost basis, on a per diem or mileage basis in lieu of actual costs incurred, or on a combination of the two, provided the method used is applied to an entire trip and not to selected days of the trip, and results in charges consistent with those normally allowed in like circumstances in the non-profit organization's non-federally-sponsored activities.

75. Travel costs incurred by employees whose work benefits multiple cost objectives should be allocated using methods consistent with those used for allocating the personnel costs of the employees involved. See PARs Toolkit for guidance on documenting personnel costs.

b. Lodging and subsistence. Costs incurred by employees and officers for travel, including costs of lodging, other subsistence, and incidental expenses, shall be considered reasonable and allowable only to the extent such costs do not exceed charges normally allowed by the non-profit organization in its regular operations as the result of the non-profit organization's written travel policy. In the absence of an acceptable, written non-profit organization policy regarding travel costs, the rates and amounts established under subchapter I of Chapter 57, Title 5, United States Code ("Travel and Subsistence Expenses; Mileage Allowances"), or by the Administrator of General Services, or by the President (or his or her designee) pursuant to any provisions of such subchapter shall apply to travel under Federal awards (48 CFR 31.205–46(a)).

c. Commercial air travel. (1) Airfare costs in excess of the customary standard commercial airfare (coach or equivalent), Federal Government contract airfare (where authorized and available), or the lowest commercial discount airfare are unallowable except when such accommodations would: require circuitous routing; require travel during unreasonable hours; excessively prolong travel; result in additional costs that would offset the transportation savings; or offer accommodations not reasonably adequate for the traveler's medical needs. The non-profit organization must justify and document these conditions on a case-by-case basis in order for the use of first-class airfare to be allowable in such cases.

(2) Unless a pattern of avoidance is detected, the Federal Government will generally not question a non-profit organization's determinations that customary standard airfare or other discount airfare is unavailable for specific trips if the non-profit organization can demonstrate either of the

following: that such airfare was not available in the specific case; or that it is the non-profit organization's overall practice to make routine use of such airfare.

d. Air travel by other than commercial carrier. Costs of travel by non-profit organization-owned, -leased, or -chartered aircraft include the cost of lease, charter, operation (including personnel costs), maintenance, depreciation, insurance, and other related costs. The portion of such costs that exceeds the cost of allowable commercial air travel, as provided for in subparagraph] c., is unallowable.

e. Foreign travel. Direct charges for foreign travel costs are allowable only when the travel has received prior approval of the awarding agency. Each separate foreign trip must receive such approval. For purposes of this provision, "foreign travel" includes any travel outside Canada, Mexico, the United States, and any United States territories and possessions. However, the term "foreign travel" for a non-profit organization located in a foreign country means travel outside that country.

52. Trustees.⁷⁶ Travel and subsistence costs of trustees (or directors) are allowable. The costs are subject to restrictions regarding lodging, subsistence and air travel costs provided in paragraph 51 of this appendix.

76. Trustee or Director costs are administrative costs and should be allocated utilizing methods consistent with the allocation of other administrative costs.

Appendix C to Part 230—Non-Profit Organizations Not Subject to This Part

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1. Advance Technology Institute (ATI), Charleston, South Carolina
2. Aerospace Corporation, El Segundo, California
3. American Institutes of Research (AIR), Washington DC
4. Argonne National Laboratory, Chicago, Illinois
5. Atomic Casualty Commission, Washington, DC
6. Battelle Memorial Institute, Headquartered in Columbus, Ohio
7. Brookhaven National Laboratory, Upton, New York
8. Charles Stark Draper Laboratory, Incorporated, Cambridge, Massachusetts
9. CNA Corporation (CNAC), Alexandria, Virginia
10. Environmental Institute of Michigan, Ann Arbor, Michigan
11. Georgia Institute of Technology/Georgia Tech Applied Research Corporation/Georgia Tech Research Institute, Atlanta, Georgia
12. Hanford Environmental Health Foundation, Richland, Washington
13. IIT Research Institute, Chicago, Illinois
14. Institute of Gas Technology, Chicago, Illinois
15. Institute for Defense Analysis, Alexandria, Virginia
16. LMI, McLean, Virginia
17. Mitre Corporation, Bedford, Massachusetts
18. Mitretek Systems, Inc., Falls Church, Virginia
19. National Radiological Astronomy Observatory, Green Bank, West Virginia
20. National Renewable Energy Laboratory, Golden, Colorado
21. Oak Ridge Associated Universities, Oak Ridge, Tennessee

22. Rand Corporation, Santa Monica, California
23. Research Triangle Institute, Research Triangle Park, North Carolina
24. Riverside Research Institute, New York, New York
25. South Carolina Research Authority (SCRA), Charleston, South Carolina
26. Southern Research Institute, Birmingham, Alabama
27. Southwest Research Institute, San Antonio, Texas
28. SRI International, Menlo Park, California
29. Syracuse Research Corporation, Syracuse, New York
30. Universities Research Association, Incorporated (National Acceleration Lab), Argonne, Illinois
31. Urban Institute, Washington DC
32. Non-profit insurance companies, such as Blue Cross and Blue Shield Organizations
33. Other non-profit organizations as negotiated with awarding agencies

A-133 Compliance Guide

What is the A-133 Compliance Supplement?

The A-133 Compliance Supplement

http://www.whitehouse.gov/omb/circulars/a133_compliance_supplement_2012 is published by the Office of Management and Budget primarily to assist auditors performing A-133 Audit engagements. OMB updates the Guide regularly by publishing periodic supplements to highlight issues which they believe require substantial attention from auditors. The above link is to the most recent supplement, September 2012, but Toolkit readers should check the OMB website to be sure you are utilizing the most recently issued supplement. The A-133 Compliance Supplement identifies existing important compliance requirements that the Federal Government expects to be considered as part of an A-133 audit. Without this Supplement, auditors would need to research many laws and regulations for each program under audit to determine which compliance requirements are important to the Federal Government and could have a direct and material effect on a program. Providing this Supplement is a more efficient and cost-effective approach to performing this research. The Supplement provides a source of information for auditors to understand the program objectives, procedures, and compliance requirements relevant to the audit as well as audit objectives and suggested audit procedures for determining compliance with these requirements for the Federal programs which are included in the supplement.

This Supplement also provides guidance to assist auditors in determining compliance requirements relevant to the audit, audit objectives, and suggested audit procedures for programs not included herein. For single audits, this Supplement replaces agency audit guides and other audit requirement documents for individual Federal programs.

How Could the A-133 Compliance Supplement Be Useful to CAA Managers?

The Compliance Supplement provides resources for CAAs to use in evaluating their current practices, including internal controls and compliance systems relating to cost allocation. It allows CAA managers to understand the questions that auditors will ask and procedures they will undertake to determine whether an organization has complied with the requirements of OMB A-122, as well as with other requirements for the management of federal funds.

Which Parts of the Compliance Supplement Will be Most Useful to Your CAA?

Part 2 of the Compliance Supplement includes an extremely useful matrix of the federal requirements which apply to various federal programs. It can provide a starting point for creating your own matrix of compliance requirements for all of your grants and awards.

Part 3 provides a summary of the major requirements for managing federal funds, including a useful discussion of ARRA requirements. In this and subsequent parts, the supplement suggests specific audit procedures. Understanding the procedures which OMB is recommending to auditors will help you be sure that you are ready to provide your auditor with access to the information needed to perform these procedures. Part 3 highlights 14 significant compliance requirements common to all federal awards, including cost allocation:

- A. Activities Allowed or Unallowed
- B. **Allowable Costs/Cost Principles**
- C. Cash Management
- D. Davis-Bacon Act
- E. Eligibility
- F. Equipment and Real Property Management
- G. Matching, Level of Effort, Earmarking
- H. Period of Availability of Federal Funds
- I. Procurement and Suspension and Debarment
- J. Program Income
- K. Real Property Acquisition and Relocation Assistance
- L. Reporting
- M. Sub-recipient Monitoring
- N. Special Tests and Provisions

Part 4 provides more detailed guidance for audits of specific federal programs. It is organized through a list of federal departments (in alphabetical order, followed by four federal agencies that do not use the word department in their names). You will need to know the Catalog of Federal Domestic Assistance (CFDA) number for each of your programs to determine whether the current Compliance Supplement contains guidance for audit objectives and procedures relating to them. If you do not see the CFDA number for one of your significant programs in the current Compliance Supplement, you can search earlier supplements online to determine whether guidance has been offered previously.

Part 5 explains the concept of clusters of programs which is used by auditors to determine which programs must be considered “major” for purposes of the A-133 audit. This is a technical section so you may find it easier to simply discuss whether the concept of clusters of programs will have an impact on your audit.

Part 6 provides auditors with detailed information about the types of controls which should be present to address 13 of the 14 compliance requirements that are highlighted in the matrix in Part 2. It also provides a detailed discussion of controls required for ARRA funds. Part 6 can be an extremely valuable tool for CAAs working to strengthen their internal controls. Part 6 organizes its discussion of necessary internal controls in the COSO Framework (see Office of Community

Services IM-112 for discussion of the critical importance of the COSO Framework for CSBG recipients). The COSO Framework focuses on five key aspects of an effective system of internal controls: control environment, risk assessment, control activities, information and communication, and monitoring. Part 6 will be extremely useful for CAAs preparing revised fiscal policies and procedures.

For more information on IM 112, please see the Community Action Partnership's [IM 112 Quick Reference Guide](#) found on the Partnership's website at www.communityactionpartnership.com.

Part 7 provides guidance for compliance issues in federal programs which are not specifically referenced in Part 4 – sort of an “all the rest” section. It includes a useful discussion of audit procedures and concerns for ARRA funds, as well as a helpful explanation of how auditors are to think about the risk of noncompliance and the controls which must be in place to address the most significant risks. This is a great resource for CAAs that want to think through opportunities for a more cost effective approach to internal controls and compliance.

Resource Directory

A-122 Resources

Right on the Money: An Annotated Guide to the Federal Cost Principles for Nonprofit Grantees (2 C.F.R. Part 230), by Anita Lichtblau, Esq., and Michael Maddox, CPA, published by CAPLAW, <http://www.capl原因.org/resources/publications.html>

OMB Circular A-122 – now in Code of Federal Regulations 2 CFR Part 230

http://www.whitehouse.gov/omb/circulars_a122_2004

http://ecfr.gpoaccess.gov/cgi/t/text/text-idx?c=ecfr&tpl=/ecfrbrowse/Title02/2cfr230_main_02.tpl

Department of Health and Human Services, Division of Cost Allocation

Guidance for Negotiating a Federal Indirect Cost Rate

<http://rates.psc.gov/>

HHS Division of Cost Allocation Guide for Reviewing Nonprofit Proposals for Indirect Cost Rates

<http://rates.psc.gov/fms/dca/negrev4.pdf>

HHS Division of Cost Allocation Sample Proposal for Indirect Cost Rate

http://rates.psc.gov/fms/dca/np_exall2.html

A-133 Compliance Supplement:

http://www.whitehouse.gov/omb/circulars/a133_compliance_supplement_2012

CSBG Resources

CSBG regulations from Code of Federal Regulations:

<http://law.justia.com/cfr/title45/45-1.0.1.1.53.9.html>

CSBG Statute:

<http://uscode.house.gov/download/pls/42C106.txt>

CSBG Guidance on Administrative Costs – IM 37

<http://www.acf.hhs.gov/programs/ocs/resource/im-no-37-definition-and-allowability-of-direct-and-administrative-cost>

Advocating that CAAs Without Direct Federal Relationships Negotiate an Indirect Cost Rate– IM 20

<http://www.acf.hhs.gov/programs/ocs/resource/im-no-20-a-discussion-of-indirect-cost-rate-principles>

Head Start Resources

Head Start Standards

<http://eclkc.ohs.acf.hhs.gov/hslc/standards>

Cost Allocation Narrative for Head Start

<http://eclkc.ohs.acf.hhs.gov/hslc/tta-system/operations/Fiscal/Narrative%20Discussions/Cost%20Allocation.htm>

Distribution of Costs in a Head Start Budget

http://eclkc.ohs.acf.hhs.gov/hslc/tta-system/operations/Fiscal/Financial%20Management/Budgets/fiscal_ime_00060a3_081605.html

Step-by-Step Guide to Creating a Cost Allocation Plan

Cost Allocation Plan Development Guide

Caution: Your cost allocation plan must be tailored to fit the specific policies and procedures of your organization. This guide is intended to assist you with development of a cost allocation plan that reflects the realities of your organization. This guide is intended for use by CAAs that do not have a federally negotiated indirect cost rate.

Avoid copying the examples of approaches to cost allocation that are included in this guide unless these are actually the approaches that you will use in your organization. Adopting a cost allocation plan which does not reflect your actual practices is a potentially dangerous error. Audit and review procedures involve careful comparison of the cost allocation practices actually used to the organization's written cost allocation plan. Failure to follow the cost allocation policies and procedures contained in the written cost allocation plan can give rise to findings even when the actual cost allocation practices utilized would have met the requirements of A-122.

Federal funds recipients must have a system in place to equitably charge costs. Additionally, as required by Office of Management and Budget Circular A-122, time distribution records must reflect an after-the-fact determination of the actual activity of each employee. Considerations in determining an appropriate method for allocating costs include the relative benefits received, the materiality of the cost, and the amount of time and cost to perform the allocation.

Cost Allocation Plan Topics

1. Purpose of the Cost Allocation Plan
2. Direct and Shared Costs Defined
3. Cost Objectives and Cost Centers
4. Cost Allocation Methods
5. Allocation of Administrative Costs
6. Examples

1. Purpose of the Cost Allocation Plan

The purpose of the cost allocation plan is to summarize, in writing, the methods and procedures that this organization will use to allocate costs to various programs, grants, contracts and agreements.

OMB Circular A-122, “Cost Principles for Non-Profit Organizations,” establishes the principles for determining costs of grants, contracts and other agreements with the Federal Government. Your cost allocation plan must comply with these requirements. You may also need to address additional requirements contained in specific funding agreements.

Principles of Cost Allocation

State the core principles that will guide your organization’s approach to cost allocation. For example, your plan may be based on principles such as those listed below:

1. Only costs that are allowable, in accordance with the cost principles, will be allocated to benefiting programs.
2. All allowable direct costs are charged directly to programs, grants, activity, etc.
3. Allowable direct costs that can be identified to more than one program are allocated individually as direct costs using an allocation method that is appropriate to the particular cost being allocated.
4. All other allowable general and administrative costs (costs that benefit all programs and cannot be identified to a specific program) are allocated to programs, grants, etc. using an allocation method that results in an equitable distribution.

2. Direct Costs

Direct Costs

Your plan should state the definition of direct costs which you will utilize, for example:

“Direct costs are those that can be identified specifically with a particular final cost objective.”

Shared Costs

Your plan should define the types of costs which will be considered to be shared costs and will be allocated through your cost allocation plan. While such costs are often referred to as indirect costs, it may be helpful to use the term “shared” costs to avoid potential confusion with the use of the term “indirect” for costs that are incorporated into a federally negotiated indirect cost rate.

For example, your plan could state:

“Shared costs are those that have been incurred for common or joint objectives and cannot be readily identified with a particular final cost objective.”

3. Cost Objectives and Cost Centers

A-122 states the term cost objective may be used to describe a grant, contract, project, service, or other activity. This section of your plan should describe the overarching structure you will use in accounting for costs that are associated with specific program and administrative functions and to identify costs with specific funding awards. In accounting terminology the concept of a cost objective is commonly referred to as a cost center. Typically, general ledger accounting systems are structured using distinct cost centers to record information about revenues and expenses associated with specific grants, contracts, projects, services or other activities.

Your cost allocation plan must describe the method you have chosen to structure your cost center/cost objective system. Some CAAs choose to define cost objective as being essentially synonymous with “grant or contract”. Other CAAs define their cost objectives as “programs”. In this approach, the CAA also establishes sub-cost centers or funding source codes to capture information about which funding source will cover the various costs that will be recorded in each cost center. This second approach is helpful when some programs have multiple funding sources.

Describing your CAAs structure for tracking cost objectives/cost centers accurately is extremely important. It is part of the foundation of your approach to cost allocation.

4. Cost Allocation Methods

This section of your plan should state the cost allocation methods and procedures that your organization will use for various types of costs.

For example, you might state:

- A. **Compensation for Personal Services** – XYZ complies with the requirements of A-122 for contemporaneously maintained records of the employee time and effort through completion by each employee of Personnel Activity Reports for each pay period (See PARs Toolkit for examples).

Salaries and Wages:

Personnel Activity Reports will be utilized to determine the cost objectives which have benefited from the work of each employee. The cost of salaries and wages for employees whose work has benefited only one cost objective in a pay period will be charged to that cost objective. The cost of salaries and wages for employees whose work has benefited more than one cost objective in a pay period will be allocated to the benefiting cost objectives through use of an estimating formula based upon the percentage of the employee’s efforts which have been attributed to that cost objective divided by that employee’s total efforts. For non-exempt employees the formula will be based upon the percentage of hours worked reported in each pay period. For exempt employees, the percentage of effort reported by the employee on the Personnel Activity report will be the basis for the allocating percentage. The cost of salaries and wages for employees whose work has benefited all cost objectives will be allocated using the method for allocation of administrative costs described in Section 5.

Fringe benefits:

Fringe benefits (FICA, UC, and Worker's Compensation) are allocated in the same manner as salaries and wages. Health insurance, dental insurance, life & disability and other fringe benefits are also allocated in the same manner as salaries and wages.

Vacation, holiday, and sick pay:

Vacation, holiday, and sick pay are accrued as earned and with the accrue expense allocated in the same manner as salaries and wages. (Note: use this statement only if your organization uses the accrual method for recording vacation, holiday and sick pay expenses. The use of the cash basis for these benefits may pose complications when awards that give rise to the vacation, holiday, and sick pay obligations are discontinued prior to employees utilizing their full accrued benefits.

B. **Travel Costs** - Travel costs are allocated based on purpose of travel. All travel costs (local and out-of-town) are charged directly to the program for which the travel was incurred. Travel costs that benefit more than one program will be allocated to those programs based on the percentage of employee time and effort which is computed from the employee's Personnel Activity Report for the pay period in which the travel occurs. Travel costs that benefit all programs, such as those incurred by staff performing overall agency administrative functions will be allocated using the methods described in Section 5 for allocation of administrative costs.

C. **Professional Services Costs** (such as consultants, accounting and auditing services) will be allocated to the cost objective benefiting from the service. All professional service costs are charged directly to the program for which the service was incurred.

Costs that benefit more than one program will be allocated to those programs based on the following methods:

- Consultation relating to the performance of agency-wide financial management functions such as the annual audit will be allocated using the methods described in Section 5.
- Consultation relating to the facilities, such as consultation on facilities maintenance issues, will be allocated by square footage based upon the methods described in Paragraph I in this section.
- Consultation regarding program issues will be allocated based upon the consultant's detailed billing of use of consultant time and/or fees for specific deliverables.

D. **Office Expense and Supplies** (including office supplies and postage) will be allocated based on usage. Expenses used for a specific cost objective will be charged directly to that program. Postage expenses are charged directly to cost objectives to the extent possible through the use of a coded postage meter. Costs that benefit more than one program will be allocated to those cost objectives based on the percentage of FTE (based on Personnel Activity Reports) allocated to each cost objective during the relevant time period. Costs that benefit all cost objectives will be allocated based the methods described in Section 5.

E. **Depreciation and Equipment:** Items with costs below \$xxxx are reflected in the supplies category and expensed in the current year. Items which exceed \$xxxx are deemed equipment in accord with our capitalization policy. Unless not allowed by the awarding agency, equipment

purchases are recovered through depreciation. Depreciation costs for allowable equipment used solely by one cost objective are charged directly to the cost objective using the equipment. If more than one program uses the equipment, then an allocation of the depreciation costs will be based on the extent to which each program uses the equipment as determined by equipment sign-out records (this would typically be used for vehicles) or by percentage of FTE effort devoted to each program based upon Personnel Activity Report records for the appropriate time period. Costs that benefit all programs will be allocated based on the method described in Section 5.

- F. **Printing** (including supplies, maintenance and repair) - Expenses are charged directly to cost objectives that benefit from the service. Expenses that benefit more than one cost objective are allocated based on the ratio of the percentage of FTE devoted to each cost objective for the time period as reflected on the PARs. Costs that benefit all programs will be allocated based on the methods described in Section 5.
- G. **Insurance** - Insurance needed for a particular program is charged directly to the program requiring the coverage. Other insurance coverage that benefits all programs is allocated using the methods described in Section 5.
- H. **Telephone/Communications** - Long distance and local calls are charged to programs if readily identifiable. Other telephone or communications expenses that benefit more than one program will be allocated to those programs based on the percentages of FTEs allocated to each program as documented through the PARs for the relevant time periods. Costs that benefit all programs will be allocated based on methods described in Section 5.
- I. **Facilities Expenses** - Allocated based upon usable square footage. The ratio of total square footage used by personnel and activities related to each cost objective to total square footage is calculated. Facilities costs related to general and administrative activities are allocated to programs based upon the methods described in Section 5.
- J. **Training/Conferences/Seminars** – Allocated to the program benefiting from the training, conferences or seminars. Costs that benefit more than one program will be allocated to those programs based on the ratio of each program’s FTEs to the total of such FTEs for the benefiting programs as determined through the PARs reports for the time period. Costs that benefit all programs will be allocated based on the methods described in Section 5.
- K. **Other Costs** (including dues, licenses, fees, etc.) - Other joint costs will be allocated on a basis determined to be appropriate to the particular costs. *(Describe other cost line items and the allocation methods which will be used.)*
- L. **Unallowable Costs** – A cost center will be established for costs that are unallowable in accordance with OMB Circular A-122, including alcoholic beverages, bad debts, advertising (other than help-wanted ads), contributions, entertainment, fines and penalties. Lobbying and fundraising costs are also unallowable costs for the use of federal funds. Direct costs associated with lobbying and fund raising will be tracked in separate cost centers and allocated the appropriate share of shared costs utilizing the methods described above. Methods for allocation of administrative costs to the lobbying and fund raising cost centers are described in Section 5.

5. Allocation of Administrative Costs

OMB A-122 defines administrative costs as costs of “general administration and general expenses such as the director's office, accounting, personnel” (Attachment A, Section C.3). Costs which are directly associated with performance of administration as defined in A-122 will be charged to the Administrative Cost Center. The Administrative Cost Center will also be charged for its fair share of costs which benefit administrative as well as program functions using the methods described above in Section 4.

Compensation costs charged to the Administrative Cost Center will be allocated to specific cost objectives utilizing the following methods:

1. Staff performing administrative functions will be required to describe the activities they perform in each pay period on their Personnel Activity Report. The reports will be analyzed to determine what portion of each employee's effort was devoted to activity which could reasonably be associated with a specific cost center. This information will be utilized to compute the percentage of the employee's compensation for that pay period which will be charged to that benefitting cost objective.
2. The remaining percentage of the cost of each employee's administrative efforts will be allocated among all cost centers utilizing estimates based on the following analysis:
 - HR administrative efforts will be allocated based on the number of employees assigned to each cost objective;
 - Accounts Payable related efforts will be allocated based on the percentage of transactions processed for each cost objective;
 - High level management efforts such as organization-wide financial analysis performed by the CFO or Board Development and Support activities performed by the CEO will be allocated based on the percentage of organization-wide FTE providing benefit to various cost objectives as determined from analysis of PARs for the relevant pay period.

6. Examples:

Example 1

Expense Amount = \$5,000

Costs that benefit two or more specific programs, but not all programs, are allocated to those programs based on the ratio of each program's FTE's to the total FTE of all benefiting programs:

Grant	FTE per PARs	%	Amount Allocated
A	2	20%	\$1,000
C	3	30%	\$1,500
E	5	50%	\$2,500
Total	10	100%	\$5,000

Example 2

Expense Amount = \$10,000

Costs that benefit **all** programs and **administration** are allocated based on a ratio of each program's FTEs:

Grant	FTE per PARs	%	Amount Allocated
A	20	20%	\$2,000
B	7	7%	\$ 700
C	20	20%	\$2,000
D	27	27%	\$2,700
E	16	16%	\$1,600
G& A	10	10%	\$1,000
Total	100	100%	\$10,000

Example 3

Facilities Expense Amount = \$10,000

Facilities costs are allocated based on square footage. Square footage for each program and general and administrative activity is considered in the analysis. General and administrative facilities costs are further allocated to each program based on the square footage of each grant program to the total square footage of all grant programs. The calculation is as follows:

Grant	Square Footage	%	Amount Allocated	G&A Allocated	Total Amount Allocated
A	300	30%	\$ 3,000	\$ 340	\$ 3,340
B	100	10%	\$ 1,000	\$ 110	\$ 1,110
C	200	20%	\$ 2,000	\$ 220	\$ 2,220
D	200	20%	\$ 2,000	\$ 220	\$ 2,220
E	100	10%	\$ 1,000	\$ 110	\$ 1,110
G&A	100	10%	\$ 1,000	0	0
Total	1,000	100%	\$10,000	\$1,000	\$10,000

Example 4

Expense Amount = \$100,000

Costs related to the performance of Administrative functions such as Accounts Payable that benefit all programs and are most fairly allocated through the computation of the percentage transactions processed for the benefit of each program. Note that some Accounts Payable transactions are related to Administrative activities, for example, paying the bill for the audit. In this example, G&A receives a share of the cost of the Accounts Payable function:

Grant	# of transactions processed	%	Amount Allocated
A	200	20%	\$20,000
B	50	5%	\$5,000
C	210	21%	\$21,000
D	300	30%	\$30,000
E	200	20%	\$20,000
G&A	40	4%	4,000
Total	1000	100%	\$100,000

Example 5

Expense Amount = \$400,000

Costs related to the performance of Administrative functions that benefit **all** programs and are most fairly allocated through the computation of the percentage of total FTE attributed to each program:

Grant	FTE per PARs	%	Amount Allocated
A	20	22%	\$88,000
B	7	8%	\$32,000
C	20	22%	\$88,000
D	27	30%	\$120,000
E	16	18%	\$72,000
Total	90	100%	\$400,000

FAQs About the Pros and Cons of Obtaining a Federally Negotiated Indirect Cost Rate

1. Which CAAs Are Able to Choose Whether to Obtain an NICR?

Only organizations receiving direct federal awards are able to obtain Negotiated Indirect Cost Rates (NICR). Organizations with no direct federal awards must develop and implement cost allocation plans to justify charging portions of various shared costs to awards which include federal dollars.

Some CAAs with direct federal awards are required to obtain negotiated indirect cost rates by one or more of their funders. Other CAAs with direct federal awards are permitted to choose whether or not they will obtain a negotiated indirect rate.

2. How Does a Nonprofit Obtain an NICR?

To obtain an NICR, a nonprofit must first determine which federal agency will serve as its cognizant agency and obtain guidance from that agency regarding the process for submitting proposals for determination of an indirect cost rate. For most CAAs, the U.S. Department of Health and Human Services (“HHS”) will be the cognizant agency and negotiations will be carried out with the Division of Cost Allocation.

After establishing initial contact with the appropriate cognizant agency, the nonprofit prepares a proposal which identifies the costs it will consider to be indirect and the method it will use to compute the percentage of direct costs that the indirect costs will comprise. In preparing its proposal for the indirect cost rate, the nonprofit must make a series of choices regarding which costs will be included in the indirect rate, and how the percentage of indirect costs to direct costs will be computed.

The details of these choices lie outside the scope of this Toolkit. However, at a basic level, the choices about which costs will be included in the indirect cost category involve deciding whether to include only administrative costs or to include both administrative costs and facilities costs as indirect costs. The choices regarding the computation of indirect costs as a percentage of direct costs involves deciding what base or denominator will be used in the fraction which treats indirect costs as the numerator and direct costs as the denominator. Very simply stated, the nonprofit may choose to use either Salaries and Wages, total compensation (including payroll taxes and benefits as well as salaries and wages), or total direct costs (subject to some important exclusions). Detailed information about the calculation of the indirect cost rate is available in OMB Circular A-122 Section C in Appendix A and in the instructions provided by cognizant agencies.

The nonprofit submits its proposal to the Division of Cost Allocation of their cognizant agency and engages in discussion with the officer assigned to their proposal. After discussion, the Division of Cost Allocation informs the nonprofit of the rate that has been approved for the organization and the time period that the approval of the rate will cover.

Once the rate has been approved, the nonprofit may begin requesting reimbursement for indirect costs at the approved rate as part of its financial reporting on federal awards. Of course, in the end, the nonprofit will only be entitled to recover the actual indirect cost it incurs during the award period. More detail on the requirements for tracking and substantiating indirect costs are provided in FAQ 4 below.

3. What are the Benefits of Obtaining an NICR?

Organizations with a negotiated indirect cost rate are permitted to charge all federal awards for indirect costs as a line item in their financial reports. The benefits of having an NICR include:

- **Simplicity:** indirect costs can be computed using the agreed upon percentage and reported on the indirect cost line of federal award financial reports;
- **Certainty:** the nonprofit knows the maximum amount of indirect costs that may be charged to federal awards and the types of costs that can and cannot be included in the indirect cost category;
- **Clarity for budget preparation:** the nonprofit is able to use the approved NICR in budget proposals for additional federal funds;
- **Streamlined process for recovering administrative costs:** Employees performing entirely administrative functions that are included in the indirect cost category are not required to maintain Personnel Activity Reports (see the PARs Toolkit). Their time is charged to the administrative cost center and the cost of their employment is recovered through the NICR. Caution is needed in this area because some employees performing significant administrative functions, for example the CEO, also perform some functions which should be characterized as program or unallowable costs such as lobbying or fundraising, resulting in the need for more detailed recordkeeping and reporting in a PAR; and
- It may be difficult to find a method of allocating some shared costs, such as time spent by an director on activities that benefit the CAA as a whole, that will satisfy all of the CAA's funding sources. Having an NICR avoids needing to justify a method for allocating costs associated with performance of administrative functions that benefit all programs and functions in the nonprofit.

4. What Accounting and Recordkeeping is Required for Organizations with an NICR?

Organizations with an NICR must structure their accounting system to maintain a detailed record of all costs charged to the indirect cost center. In most cases, organizations which have chosen to include facilities and other shared costs along with administrative costs in their indirect rate, will choose to maintain two sub-cost centers of the indirect cost center, one for administrative costs and the other for facilities and other shared costs. While this structure is not required, it is extremely helpful for dealing with various funding agreements which impose specific limits on administrative costs.

Care is required to ensure that the coding of costs as indirect is consistent with the methods used in the indirect cost rate proposal. Management must monitor the costs actually charged to the indirect cost center to identify any significant variances from the approved NICR. If actual indirect costs are significantly lower than the indirect costs anticipated in the NICR proposal, management must decide whether to continue recovering indirect costs at the approved rate or to report actual indirect costs. If the actual indirect costs incurred by the end of the fiscal year are lower than the amount

that has been recovered through reporting indirect costs at the approved indirect cost rate, action will be needed to true up the reporting to the actual expenses.

5. What are the Potential Drawbacks or Problems with Having an NICR?

For nonprofits receiving only a relatively small proportion of their total income from direct federal awards, an NICR can be quite problematic. One of the key requirements for using an NICR is that the same indirect cost rate be charged to all cost objectives/cost centers. For example, a CAA that has obtained an NICR of 20% of direct program costs must charge indirect costs equal to 20% of direct program costs to each cost objective/cost center. This requirement includes making this fair charge to cost centers in which the primary funder refuses to pay any indirect costs, establishes a lower maximum rate, or allows only specific line items of shared costs to be charged.

In this situation, the nonprofit must demonstrate that it has unrestricted funds available to cover the difference between the indirect costs charged based on the NICR and the contribution towards these costs that the funders of a specific program/cost objective will provide. It is not permissible to reduce the rate of indirect costs charged to cost centers based on the lack of funds available to meet the approved indirect cost rate and to then have the other funding sources in the indirect cost pool pick up the difference.

A related drawback arises when some federal programs have statutory provisions that limit the amount of indirect or administrative costs which may be charged or provisions which require defining administrative costs differently than they are defined in A-122.

Additional complications can arise when federal funds are administered through state or local government, with the nonprofit functioning as a sub recipient. In some cases, the state or local government imposes limitations of the amount of indirect costs which may be charged to particular awards. If those limits fall below the nonprofit's approved indirect cost rate, the nonprofit will need to document the availability of unrestricted funds to cover the gap between the NICR and the rate permitted under the state or local award agreement.



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