

**A GUIDE FOR  
STATE, LOCAL AND INDIAN TRIBAL  
GOVERNMENTS**

**COST PRINCIPLES AND PROCEDURES FOR  
DEVELOPING COST ALLOCATION PLANS AND  
INDIRECT COST RATES FOR AGREEMENTS  
WITH THE FEDERAL GOVERNMENT**

**IMPLEMENTATION GUIDE FOR  
OFFICE OF MANAGEMENT AND BUDGET  
CIRCULAR A-87**

**ASMB C-10**

**Cost Principles and Procedures for  
Establishing Cost Allocation Plans and Indirect Cost Rates  
for Agreements with the Federal Government**

**A GUIDE FOR STATE, LOCAL AND INDIAN TRIBAL GOVERNMENTS**

**This guide is intended to assist state, local, and Indian tribal governments in applying Office of Management and Budget Circular A-87, which provides principles and standards for determining costs applicable to Federal grants and contracts performed by state, local, and Indian tribal governments.**

**The procedures in this guide are applicable to grants and contracts awarded by all Federal agencies and have been developed in coordination with the Office of Management and Budget.**

**This document replaces "A Guide for State and Local Government Agencies" (OASC-10),  
published December 1976**

**8 April 1997**

**U.S. Department of Health and Human Services**

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**April 8, 1997**

**TO USERS OF OMB CIRCULAR A-87 - COST PRINCIPLES FOR STATE,  
LOCAL AND INDIAN TRIBAL GOVERNMENTS**

Dear Colleague:

The Office of Management and Budget, in Circular A-87, mandates that the Department of Health and Human Services issue implementing material for that document on behalf of the Federal Government. The accompanying *Cost Principles and Procedures for Establishing Cost Allocation Plans and Indirect Cost Rates for Agreements with the Federal Government* reflects our efforts to satisfy that mandate. This brochure, last issued in 1976 under the reference OASC-10, is being assigned the new reference number ASMB C-10.

I want to acknowledge the efforts of the Office of Audit Resolution and Cost Policy, in the Office of Grants and Acquisition Management, who had the responsibility for developing this brochure. I also wish to thank the HHS staff, those of other Federal agencies, and OMB who provided much appreciated assistance on this project. Lastly, I would like to acknowledge Management Concepts, Inc., of Vienna, Virginia, who provided advice, layout, and editorial support.

As will be noted, the C-10 is issued in loose-leaf form. Users are encouraged to maintain a subscription with the Government Printing Office in order that they can receive up-dates and changes in the future. This document can also be accessed on HHS's GrantsNet: <http://www.os.dhhs.gov/progorg/GrantsNet/index.html>. This document may be reproduced without permission.

We welcome your comments and inquiries. Please address them to:

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Sincerely,

Terrence Tychan  
Deputy Assistant Secretary for  
Grants and Acquisition Management

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# PREFACE

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This guide contains, by reference, Office of Management and Budget (OMB) Circular A-87, *Cost Principles for State, Local and Indian Tribal Governments*, and guidance for its interpretation and implementation. Circular A-87 provides both Federal agencies and Federal award recipients with a uniform approach to determining costs of Federally funded programs. This guide also presents information about the preparation, submission, review, and audit of cost allocation plans and indirect cost rate proposals by governmental units. Procedures in this guide are applicable to cost-based awards made by all Federal agencies unless specifically provided otherwise. This guide has been developed in coordination with OMB.

This guide provides clarification and procedural guidance to implement the Circular. It is intended to be consistent with the Circular and all other applicable policies. Circular A-87 is incorporated into this document as Appendix 1.

This guide consists of several parts, appendices, and a reference section. Each part of this guide focuses on a specific component of the Circular, e.g., Part 1 provides basic information about the Circular as well as details on information in the Circular, Part 2 focuses on Attachment A to the Circular, General Principles for Determining Allowable Costs, Part 3 deals with Attachment B, Selected Items of Cost, etc. The text discussion in each part is supplemented by a section on Highlights of Changes, as well as a Questions and Answers (Q&As) section intended to clarify issues relating to the respective component of the Circular. Each question is numbered and followed by a bracketed citation to the relevant section of the Circular, where applicable. On occasion, one Q&A may reference another by number.

The reference section provides a list of related publications and how to obtain them. The appendices include a copy of the May 4, 1995 revision of OMB Circular A-87 (to be provided by users), a list of cognizant agencies, and a sample indirect cost rate agreement. (At the time of this publication, OMB was in the process of revising the cognizant listing based on new criteria. When issued, it will be provided in the C-10 as Appendix 2.)

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## Reference

## Appendices

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- 3 Sample Indirect Cost Rate Agreement

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# PART 1

## Basic Information

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### 1.1 Background

#### 1.1.1 The Cost Principles

Federal cost principles are policies used to determine which costs of an activity/project/program should be borne by the Federal Government. Over the years, various sets of governmentwide cost principles have been developed for reimbursing costs for different classes of recipients. These policy documents ensure the consistent treatment of costs, regardless of whether reimbursement is received directly from the Federal Government or through another recipient of Federal funds.

#### 1.1.2 Purpose and Significance of OMB Circular A-87

Office of Management and Budget (OMB) Circular A-87 is one of several circulars intended to achieve more efficient and uniform administration of Federal awards, and to foster better relationships between the Federal Government and states, local governments, and Federally recognized Indian tribal governments. It provides the foundation for greater uniformity in the costing procedures of nonfederal governments and in the reimbursement practices of Federal agencies. It should be used in conjunction with other applicable laws to provide comprehensive direction and accountability in Federal fund management.

Circular A-87 provides principles and standards for determining both direct and indirect costs applicable to Federal cost-based awards to governmental units. Parties using the A-87 cost principles include budget preparers, recipient personnel responsible for tracking costs charged against Federal awards, independent auditors, Federal awarding agency personnel reviewing budget requests and charges to the award, and cognizant agency and recipient personnel negotiating indirect cost rates and cost allocation plans.

#### 1.1.3 Brief History of Circular A-87

1968    Circular A-87 issued by OMB

1974    Circular A-87 reissued as FMC 74-4

1981    Circular reissued as A-87, coverage extended to Indian tribal governments

- 1987 Interagency task force began review of Circular A-87
- 1988 First proposed revisions published
- 1993 Second proposed revisions published
- 1995 OMB issued significantly revised Circular A-87

#### **1.1.4 Effective Date of the Revised Circular A-87**

For indirect costs and costs covered by cost allocation plans described in Attachments C, D, and E of the Circular, the revision of Circular A-87 issued on May 4, 1995 must be applied to cost allocation plans and indirect cost rate proposals submitted or prepared for a governmental unit's fiscal year beginning on or after September 1, 1995. Therefore, for those governments with a fiscal year beginning October 1, 1995 - January 1, 1996, the revised version of Circular A-87 applies to the Central Service Plan for 1996. For all other governments, the revised Circular A-87 applies to the 1997 plan. Effectively, two plans may be required for several years, i.e., those that would close out fiscal years 1994, 1995, or 1996 (as applicable), and another plan recognizing the new principles for the year that reflects the implementation of the revised Circular A-87.

For costs other than indirect costs and costs covered by the cost allocation plans described in Attachments C, D, and E of the Circular, the revised Circular A-87 applies to all awards and amendments, including continuation and renewal awards, made on or after September 1, 1995.

#### **1.2 Role of the Office of Management and Budget**

OMB is responsible for policy direction for Circular A-87 and for providing interpretations and assistance to assure effective implementation by Federal agencies and award recipients. OMB is also responsible for assigning Federal agencies to serve as cognizant for purposes of review and approval of cost allocation plans and indirect cost rates of states and certain local and Indian tribal governments. Except as provided by statute, any exceptions to the Circular are subject to OMB approval. The Office of Federal Financial Management is the responsible unit within OMB. In the interest of uniformity, exceptions are made only where adequate justification is presented.

#### **1.3 Relationship of Circular A-87 to Other Cost Principles**

Determining which cost principles apply to a particular recipient entity is governed by the type of recipient. The chart below illustrates the cost principles and their applicability, by recipient type.

<b>For the Costs of a —</b>	<b>Use the Cost Principles in —</b>
State, local, or Indian tribal government	OMB Circular A-87
Private nonprofit organization other than (1) institution of higher education, (2) hospital, or (3) organization named in OMB Circular A-122 as not subject to that Circular	OMB Circular A-122
Educational institution	OMB Circular A-21
For-profit organization other than a hospital or an organization named in OMB Circular A-122 as not subject to that Circular	48 CFR Part 31, Contract Cost Principles and Procedures, or uniform cost accounting standards that comply with cost principles acceptable to the Federal agency
Hospital	45 CFR Part 74, Subpart E, or other cost principles acceptable to the Federal agency, e.g. HIM-15

The applicability of the cost principles flows through to the subrecipient.

<b>EXAMPLE:</b>
The State of Macedonia receives a Federal award: A-87 applies
Macedonia subawards funds to Meerkat County: A-87 applies
Meerkat County subawards funds to ProYouth, a nonprofit: A-122 applies

In other words, the type of recipient or subrecipient determines the applicable cost principles, regardless of whether funds are received directly from the Federal Government or through a subaward from a primary recipient. The exception to the above is where statutory or regulatory provisions applicable to the prime recipient are more restrictive than the cost or administrative principles applicable to the subrecipient. For example, many awards to nonprofits permit the nonfederal share to be met through in-kind matching rather than matching actual expenditures. Where the matching of actual expenditures is required of the prime recipient, then subrecipients must also match in this same manner.

#### **1.4 Relationship of Circular A-87 to Agency Regulations and Federal Statutes**

OMB Circular A-87 is a directive to the heads of Federal executive departments and agencies instructing them concerning the cost principles to be applied in cost-based awards to state, local, and Indian tribal governments. The Circular directs agencies to issue implementing regulations. In general, agencies have done so by adopting Circular A-87 by reference in Section \_\_.22 of the Common Rule accompanying OMB Circular A-102, *Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments*.

Unless specifically required by statute or an exception granted by OMB, the Circular applies to awards to states, localities, and Indian tribal governments. Once implemented or otherwise adopted within Federal agency regulations, it has the force and effect of law. However, if a statute passed by Congress prescribes policies or procedures that differ from those in the Circular, the provisions of the statute govern. For example, it is not uncommon for Congress to enact legislation that restricts certain items of costs (i.e., limitations on indirect or administrative costs). When such a restriction exists, it is binding. Note: Statutes may differ as to how they define certain elements of cost and may further differ with definitions contained in Circular A-87. For example, the terms "indirect" and "administrative" are not necessarily synonymous. Accordingly, Federal agencies and recipients should exercise care in applying Circular A-87 definitions when making judgments about the effect of statutory limitations.

### **1.5 Governmentwide Guidance on Implementing the Cost Principles**

Each type of organization performing under agreements with the Federal Government follows one of the sets of governmentwide cost principles. Various Federal agencies have developed implementation guidance for the different cost principles. These principles and guidance apply to awards received directly from the Federal Government, as well as to Federal funds passed through or awarded to the performing organization by another Federal fund recipient. The chart below summarizes the applicable cost principles and available governmentwide guidance by type of organization. The agency that developed the guidance is noted parenthetically.

<b>Organization Type</b>	<b>Federal Cost Principle</b>	<b>Governmentwide Guidance</b>
State, local, or Indian tribal governments	OMB Circular A-87	ASMB C-10 (HHS)
Nonprofit organizations	OMB Circular A-122	Various Funding Agency Guidelines
Colleges or universities	OMB Circular A-21	OASC-1 (HHS)
Commercial organizations and nonprofit organizations listed in Attachment C of A-122	Federal Acquisition Regulation, 48 CFR Part 31	none
Hospitals	45 CFR 74, Subpart E	OASC-3 (HHS)

### **1.6 Questions and Answers**

#### **1-1 What is Federal Management Circular 74-4 and does it have any relevance to current Federal cost policies?**

Federal Management Circular (FMC) 74-4 was the designation for the Cost Principles for State and Local Governments during a period of the 1970s when the Circular was incorporated into the General Services Administration manual structure. There is no

substantive difference between FMC 74-4 and OMB Circular A-87. FMC 74-4 was superseded in 1981 when OMB reissued the cost principles as Circular A-87, and is no longer applicable. However, some grant agreements and policy documents that contain references to FMC 74-4 may not have been edited to reflect the applicability of Circular A-87 and its most recent revision issued in May 1995.

**1-2 What is OASC-10? Is it relevant to current Federal cost policies?**

In 1976, the Department of Health, Education and Welfare issued "A Guide for State and Local Government Agencies – Cost Principles and Procedures for Establishing Cost Allocation Plans and Indirect Cost Rates for Grants and Contracts with the Federal Government (OASC-10)." OASC-10 is superseded and replaced by this guide, ASMB C-10, which reflects the policies in the revised Circular A-87. The guide is mandated by OMB in Circular A-87 and is a governmentwide document.

**1-3 Have any Federal awarding agencies issued agency-specific implementations of Circular A-87?**

Most agencies adopted Circular A-87 by reference in their applicable agency grants administration regulation. Generally, this reference appears in Section \_\_.22 of agency regulations implementing the Common Rule issued pursuant to OMB Circular A-102 and in Section \_\_.27 of agency regulations implementing OMB Circular A-110. However, a few Federal agencies have issued specific *Federal Register* notices concerning their implementation of the revised Circular A-87, to clarify issues such as effective dates or to codify the entire Circular into their regulations.

**1-4 Circular A-87, prior to its revision on May 17, 1995, stated that "no provision for profit or increment above allowable cost is intended." The revised Circular changed this language to read: "Provision for profit or other increment above cost is outside the scope of this Circular." Has the policy changed?**

No. Profit continues to be unallowable. In the Preamble to the Circular, OMB explains that the language was changed to be consistent with the wording in other Circulars. However, no change in policy was intended. [Circular, ¶ 5]

**1-5 In the case of state-supervised, county-administered programs, which fiscal period controls the effective date for adoption of the revised A-87? [Circular, ¶ 11]**

It must be the fiscal period of the specific unit of government. Therefore, if a state has a different fiscal period than a local government it supervises, each governmental unit would adopt the Circular in accordance with its individual fiscal period.

- 1-6 If predetermined indirect cost rates have already been approved that extend beyond the effective date for adoption of the revised Circular A-87 by a specific governmental component, does this change the effective date for that component? [Circular, ¶ 11]**

For a governmental component that already has established predetermined cost rates beyond September 1, 1995, the effective date of the revised A-87 is the start of the first accounting period for which an indirect cost rate has not been established.

- 1-7 When are interest payments on equipment allowable for an internal service fund? Would the interest be allowable after September 1, 1995 or with the first fiscal year beginning after September 1, 1995? [Circular, ¶ 11]**

Internal service funds are covered by Attachment C of A-87. The transmittal letter from OMB dated May 4, 1995 states that for costs charged indirectly or otherwise covered by the guidelines for cost allocation plans contained in Attachments C, D, and E, the effective date is the first fiscal year beginning after September 1, 1995.



# PART 2

## Attachment A — General Principles for Determining Allowable Costs

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### 2.1 Objectives of the Circular

Office of Management and Budget (OMB) Circular A-87 establishes principles for determining the allowable costs incurred by state, local, and Federally recognized Indian tribal governments (hereinafter referred to as governmental units) under grants, cost-reimbursement contracts, and other agreements with Federal agencies (hereinafter referred to as Federal awards). The principles are for the purpose of cost determination only and are not intended to dictate the extent of Federal or governmental unit participation in the financing of a particular program or project. Accordingly, they describe what may be reimbursed or recovered under a covered Federal award. They are designed to provide that the Federal Government bear its fair share of costs recognized, except where restricted or prohibited by law. Profit or other increment above cost in any Federal award is outside the scope of the Circular.

### 2.2 Governmental Unit Responsibilities

The Circular recognizes the responsibility and sovereignty of governmental units that receive and administer Federal awards. It reinforces the expectation contained in the law and in award agreements that these organizations will administer Federal funds properly and in a manner consistent with the sound management practices that they apply to their own revenues. Standards provided in the Common Rule issued pursuant to OMB Circular A-102, *Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments*, reinforce this recipient responsibility for financial management, procurement, property management, and record retention.

### 2.3 Alternative Methods of Cost Recovery

The Circular permits Federal agencies to work with governmental units that wish to test alternative methods for cost recovery in all or a portion of a Federal award. Such methods include, where permitted, fixed-amount awards, fee-for-service arrangements, and predetermined indirect cost rates. Alternative methods must comply with the A-87 "benefits received" concept.

### 2.4 Applicability

#### 2.4.1 What Types of Organizations Are Affected by Circular A-87?

Circular A-87 applies to governmental units generally, but definitions within the Circular further establish the entities that fall within that broad category. Under the Circular, the following entities are considered to be a *state government*:

- any of the 50 states;
- District of Columbia;

- Commonwealth of Puerto Rico;
- any territory or possession of the United States; and
- any agency or instrumentality of a state, exclusive of local governments.

Circular A-87's definition of local government encompasses all general and special purpose governmental units. It defines the following entities as ***local governments***:

- county;
- municipality;
- city;
- town;
- township;
- local public authority;
- school district;
- special district;
- intrastate district;
- council of governments, regardless of incorporation status as a nonprofit corporation under state law;
- any other regional or interstate, nonfederal government entity; and
- any agency or instrumentality of a local government.

The Circular defines a ***Federally recognized Indian tribal government*** as the governing body or a governmental agency of any Indian tribe, band, nation, or other organized group, including Alaskan native villages certified by the Secretary of the Interior as eligible for the special programs and services provided through the Bureau of Indian Affairs. Components are agencies or divisions within a governmental unit.

#### **2.4.2 What Types of Organizations Are Not Affected by Circular A-87?**

For purposes of cost determination, Circular A-87 does not apply to public institutions of higher education. Those organizations are subject to OMB Circular A-21, *Cost Principles for Educational Institutions*. Circular A-87 also does not apply to public hospitals. They are subject to the requirements developed by their Federal sponsoring agencies, such as the Health Care Financing Administration (HCFA). Generally, they follow cost principles issued by the Department of Health and Human Services at 45 CFR Part 74, Subpart E.

Note: Circular A-87 does affect public hospitals and institutions of higher education in one

respect. All central service or departmental costs of a covered governmental unit that are allocated or billed to those institutions are subject to the A-87 requirements. In addition, indirect cost rates and cost allocation plans approved by a cognizant agency for the government component are to be accepted by all awarding agencies. Agency cost principles apply only to those costs not covered by these agreements.

### **2.4.3 Determining Whether Circular A-87 Applies to an Award**

Circular A-87 applies uniformly to all cost-based awards made directly or indirectly to governmental units. *Cost-based* refers to those awards where the costs charged to the award form the basis for the amount reimbursed under the award. Therefore, the types of awards subject to the principles in Circular A-87 include:

- cost-reimbursement contracts;
- grants and cooperative agreements, which are cost-reimbursement type agreements, whether or not funds are provided in advance of expenditure; and
- subgrants and cost-reimbursement subcontracts awarded to governmental units under grants awarded to any type of Federal recipient.

Circular A-87 does not apply to fixed-price arrangements, unless projected costs are used in determining the amount to be awarded.

OMB occasionally elects to specifically exclude certain programs from mandatory coverage of the Circular. For example, in 1981, OMB instructed Federal agencies administering the nine block grants enacted under the Omnibus Budget Reconciliation Act of 1981 that they were not required to use the Circular as a policy governing awards under those programs. Instead, the agencies were to permit states to use "equivalent procedures of their own" to administer such programs.

### **2.5 Terms Used in Circular A-87**

Because A-87 is a policy directive affecting what costs are allowable charges to Federal programs, what costs are not allowable, and how costs must be documented, it is important that users of the Circular and this guide become familiar with definitions of key terms and how they are used. Terms may have broader, narrower, or more precise meaning than ones that are in customary or colloquial use by financial or programmatic personnel who must rely on the Circular. In addition, such terms may not be defined in other authoritative literature on which readers might normally rely.

Definitions can be found in Section B of Attachment A to the Circular. The Circular is located in Appendix 1 of this guide.

### **2.6 The Cost Reimbursement Process**

In the context of Circular A-87, the term "cost reimbursement" describes how the claims will be reviewed, accepted, and settled. Although the term cost reimbursement implies that funding is received after-the-fact, the process of cost reimbursement under Federal awards has little to do with when cash is actually received. This is because, with few exceptions, assistance award recipients receive advance funding. Grant and cooperative agreement recipients are usually permitted to draw against their award amounts in advance, so long as they 1) limit their request for funds to the minimum amount needed, and 2) time the request as close as is administratively

feasible to the actual cash outlay for direct program costs and the proportionate share of any allowable indirect costs. (See 31 CFR §205.20; §\_\_.21, OMB Circular A-102 Common Rule.) In contrast, Federal cost-reimbursement contracts are generally paid after cost has been incurred and as progress is being made toward performance.

Note: While, for cash-need purposes, advance funding might be provided under grants and cooperative agreements, the advanced funds must be viewed by recipient organizations as an accounts payable to the Federal Government.

The cost principles have a role to play at most stages of the assistance award or contract life cycle. These stages, and the role of Circular A-87 at each stage, are summarized in the chart on the following page:

At this stage in the cycle...	Circular A-87 plays this role:
Soliciting applications and/or proposals from governmental units	Awarding agency announces the applicability of the A-87 cost principles.
Preparing proposals or plans for use of funds	Applicant governmental unit includes only costs allocable, reasonable, and allowable under Circular A-87.
Notifying recipient of award	Applicable assistance or procurement award document cites the applicability of Circular A-87.
Expending funds	Governmental unit incurs costs for expenditures that are eligible under applicable program legislation, as well as allowable under Circular A-87, under control procedures that allow proper determination.
Developing and retaining documentation	As costs are incurred, governmental unit generates documentation consistent with that generated for expenditure of own-source revenue and with any specific requirements of Circular A-87 (e.g., personnel activity reports) — documentation is maintained in a system of records for at least the minimum period of time provided under § .42, OMB Circular A-102 Common Rule.
Preparing claims for direct costs and attributable indirect costs	At a frequency determined by the awarding agency and on authorized forms, governmental unit submits claims asserting that allowable and eligible costs have been incurred in accordance with A-87. Governmental unit is permitted to apply its indirect cost rate to those object class categories of expenditure to which the cognizant agency has agreed it should be applied.
Auditing Awards	Through test procedures, independent auditors or auditors representing awarding agencies review claims to determine whether incurred costs are appropriate under Circular A-87. Discrepancies are reported to awarding agencies as questioned costs requiring resolution.

## 2.7 Composition of Cost

The total amount claimable under a cost-based award covered by Circular A-87 equals the allowable direct costs, plus the allocable portion of allowable indirect costs, minus the applicable credits.

Total Amount Claimable =	allowable direct costs <i>plus</i> allocable portion of indirect costs <i>minus</i> applicable credits
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The Circular makes clear that there is no universal rule for classifying costs as direct or indirect under every governmental accounting system. The essential difference is the degree of ease with

which a cost can be readily assigned to a particular cost objective with a high degree of accuracy. Such readily assigned costs are *direct costs*. *Indirect costs* are those that cannot be readily assigned to a particular cost objective without effort disproportionate to the benefits received. However, the Circular permits minor direct cost items to be treated as indirect costs for practicality, so long as consistent treatment of all such items is maintained.

*Applicable credits* are receipts or reductions of expenditure that offset or reduce costs allocable to Federal awards as direct or indirect costs. These are to be credited to the cost objective or the award, or refunded to the awarding agency, depending upon the circumstances and the timing of their accrual or receipt.

## **2.8 General Tests of Cost Allowability**

Although Attachment B of Circular A-87 lists a number of selected items of cost, which frequently represent significant amounts in individual Federal awards or are costs for which there is a specific Federal policy, Attachment A establishes general tests of allowability that apply irrespective of whether a particular item of cost is specifically mentioned in Attachment B. These general tests frequently involve judgment and an assessment of the facts and circumstances in which the specific cost is incurred. The tests are not only listed in the Circular itself, but are frequently restated in compliance audit guidance that Federal and nonfederal auditors use to carry out field work and reporting.

### **2.8.1 Necessary and Reasonable Costs**

The first general test of allowability is that the cost be necessary and reasonable for proper and efficient performance and administration of Federal awards. A cost is *reasonable* if, in its nature and 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 cost. The question of reasonableness is particularly important when governmental units or components are predominately Federally funded. In determining reasonableness of a given cost, consideration should be given to:

- whether the cost is of a type generally recognized as ordinary and necessary for the operation of the governmental unit or the performance of the Federal award;
- the restraints or requirements imposed by such factors as sound business practices; arms-length bargaining; Federal, state, and other laws and regulations; and Federal award terms and conditions;
- market prices for comparable goods or services;
- whether the individuals concerned acted with prudence in the circumstances, considering their responsibilities to the governmental unit, its employees, the public at large, and the Federal Government; and
- significant deviations from the established practices of the governmental unit which may unjustifiably increase the Federal award's cost.

### **2.8.2 Allocable Costs**

The second general test of allowability is that the cost be allocable to Federal awards under the provisions of Circular A-87. A cost is *allocable* to a particular cost objective if the goods or

services involved are chargeable or assignable to that cost objective according to the relative benefits received. All activities which benefit from the governmental unit's indirect costs, including unallowable activities and services donated to the governmental unit by third parties, will receive an appropriate allocation of indirect costs.

Any cost allocable to a particular Federal award or cost objective under the principles in Circular A-87 may not be charged to other Federal awards to overcome fund deficiencies, to avoid restrictions imposed by law or terms of the Federal awards, or for other reasons. Such a practice constitutes unallowable cost shifting. However, this prohibition does not preclude governmental units from charging costs that are allowable and allocable under two or more awards, pursuant to existing program agreements. Such charges are viewed as "funding allocations" rather than cost allocations.

Where an accumulation of indirect costs will ultimately result in charges to a Federal award, a cost allocation plan or indirect cost rate agreement will be required as described in Attachments C, D, and E to Circular A-87.

### **2.8.3 The Other Tests of Allowability**

In addition to reasonableness and allocability, the other general tests of allowability are that the cost:

- be authorized or not prohibited under state or local laws or regulations — a governmental unit may not accept and expend Federal funds to undertake an activity for which it does not have the authority under its own state or local law or which would constitute an illegal purpose;
- conform to any limitations or exclusions set forth in the cost principles, Federal laws, terms and conditions of the Federal award, or other governing regulations as to types or amounts of cost items;
- be consistent with policies, regulations, and procedures that apply uniformly to both Federal awards and other activities of the governmental unit;
- be accorded consistent treatment — a cost may not be assigned to a Federal award as a direct cost if any other cost incurred for the same purpose in like circumstances has been allocated to the Federal award as an indirect cost;
- be determined in accordance with generally accepted accounting principles, except as otherwise provided for in Circular A-87;
- not be included as a cost or used to meet cost-sharing or matching requirements of any other Federal award in either the current or a prior period, except as specifically provided by Federal law or regulation;
- be net of all applicable credits; and
- be adequately documented.

In general, to meet the test of adequate documentation of charges under a Federal award, a governmental unit must document charges in a manner consistent with documenting

expenditures of its own source revenue. However, certain provisions of Circular A-87 and the Common Rule issued pursuant to OMB Circular A-102 provide for specific standards for certain types of costs. For example, Circular A-87 addresses documentation for employee compensation, depreciation or use allowance for assets, and various types of allocated and billed indirect costs. The A-102 Common Rule establishes documentation requirements for purchase transactions (§\_\_\_.36(b)(9)).

## **2.9 Required Government Certification**

No cost allocation plan or indirect cost rate will be approved by the Federal Government unless the plan or rate proposal has been certified by the governmental unit. Except as noted below, no indirect costs will be reimbursed unless the governmental unit has an approved rate/plan or maintains on file a certified plan/rate, as appropriate.

The Federal Government may unilaterally establish such a cost allocation plan or indirect cost rate. Such a plan or rate may be based upon audited historical data or such other data that have been furnished to the cognizant Federal agency and for which it can be demonstrated that all unallowable costs have been excluded. When a cost allocation plan or indirect cost rate is unilaterally established by the Federal Government because of failure of the governmental unit to submit a certified proposal, the plan or rate will be established to ensure that potentially unallowable costs will not be reimbursed. [See also 4.5.6, Certification of CSCAPs, and 6.4.2, Required Certifications for state and local indirect cost rate proposals.]

## **2.10 Highlights of Changes Affecting Attachment A**

- Gives Federal agencies the authority to test alternative methods of reimbursement, such as fee-for-service. [Att. A, ¶ A.2.b]
- Clarifies that, while government hospitals and educational institutions are subject to applicable requirements governing those organizations, the measurement of costs allocated or billed to them by other government departments must be made in accordance with Circular A-87 and must be accepted by all awarding agencies. [Att. A, ¶ A.3.a]
- Clarifies that subawards are subject to the cost principles applicable to the type of organization receiving the award. [Att. A, ¶ A.3.b]
- Circular A-87 is to be used as a guide in the pricing of fixed-price agreements. [Att. A, ¶ A.3.c]
- For contracts, makes Cost Accounting Standards (CAS) applicable where required. [Att. A, ¶ A.3.d]
- Expands the definition of "approval or authorization" of costs by the "awarding or cognizant agency." Clarifies that prior approval may be assumed where costs are allocated in accordance with an approved cost allocation plan. [Att. A, ¶ B.1]
- Adds new definitions for:



- Award;
- Awarding Agency;
- Central Service Cost Allocation Plan;
- Claim;
- Cognizant Agency;
- Common Rule;
- Contract;
- Governmental Unit;
- Indirect Cost Rate Proposal;
- Public Assistance Cost Allocation Plan; and
- State.

[Att. A, ¶¶ B.1-18]

- Clarifies that the definition of "cost" does not include transfers. [Att. A, ¶ B.9]
- Deleted specific prohibition that "routine costs of government" are unallowable. [Att. A, ¶ C.1.a] However, see Highlights of Attachment B, Part 3 of this guide.
- Adds a new section defining "reasonable costs" and criteria for measuring reasonableness. [Att. A, ¶ C.2]
- Clarifies that costs must be allocated to all benefitting activities, including those that are unallowable, as well as donated services. [Att. A, ¶ C.3.b]
- Clarifies when costs of activities allowable and allocable under multiple programs may be redistributed when funding ceilings for a given program are reached. (Note: not to be misconstrued as unallowable cost shifting.) [Att. A, ¶ C.3.c]
- Clarifies that direct costs are those that can be identified specifically with a particular, final cost objective. [Att. A, ¶ E.1]
- Adds a new section permitting the treatment of minor direct expenses as indirect. [Att. A, ¶ E.3]
- Adds a new section referencing other new sections dealing with the development and submission of indirect cost rates and cost allocation plans. [Att. A, ¶ F.2]

- Previous sections dealing with the allocation of interagency costs have been combined into a new section (Attachment C) which has references to additional, new sections. The previous prohibition of charging general supervision, such as department heads, has been eliminated. In lieu of developing actual indirect costs associated with the allocated service, a standard 10% of direct salaries and wages may be used. This is applicable to services that are not included as billed or allocated services included in the state/local-wide cost allocation plan (SWCAP/LOCAP). [Att. A, § G]
- Sections dealing with cost allocation plans (CAPs) have been expanded and relocated elsewhere as Attachments (C and D) in the Circular. A new section (Attachment E) is added detailing required certifications for indirect cost (IDC) agreements and cost allocation plans submitted by state/local officials. [Att. A, § H]

## **2.11 Questions and Answers on Attachment A**

### **2-1 Circular A-87 now permits testing of alternative methods of reimbursement, such as fee-for-service. Under what circumstances may such alternative systems be used? [Att. A, ¶ A.2.b]**

Alternative reimbursement systems for administrative costs might involve a rate system whereby a single rate is paid for outputs, such as the number of programmatic services performed. As with billed services, such alternatives are acceptable for payment purposes, provided that the payments are periodically reconciled to actual costs. Reimbursement systems not based on costs are only allowable where the Federal funding legislation permits such a practice. However, where it can be demonstrated clearly that an alternative system will result in less costs to the Federal Government, the cognizant/awarding agency may deem that such a system satisfies statutory language limiting reimbursement to "expenditures."

### **2-2 Some Federal programs use cost reports that apply to both proprietary and governmental organizations. These cost reports often dictate policies and/or provide for independent decisions different from what is prescribed in Circular A-87 or what has been approved by the cognizant agency with respect to cost allocation plans or indirect cost rates. Are governmental units so affected required to maintain separate reporting and accounting systems? [Att. A, ¶ A.3]**

No. Governmental units and Federal awarding agencies in the above situations are to comply with the provisions of A-87 and the costing methodology approved by the cognizant agency with respect to state/local-wide central service costs, billed services from other support agencies, and the distribution of agency/departmental overhead to direct cost objectives/programs. These indirect, overhead, "home office," and general and administrative costs are to be accepted on the awarding agency's cost report without additional review or approval. For example, the governmental unit might have a capitalization threshold higher than that allowed by the HIM-15 (the reimbursement manual used by Medicare). The indirect cost rate will reflect the higher limit. The HIM-15 provisions would only apply to direct costs.

### **2-3 For awards to subrecipients, such as nonprofits or universities, must the governmental unit recognize an indirect cost rate established with the nonprofit**

**or university by the Federal cognizant agency?** [Att. A, ¶ A.3]

No, although governmental units are encouraged to do so. Governmental units are required to reimburse and measure costs for these organizations in accordance with the applicable cost principles, in this case A-122 and A-21, respectively. As such, the full reimbursement of allowable direct and indirect costs is expected.

The above-referenced cost principles do provide various methods for measuring costs. For example, the cognizant agency may have used a salary and wage base for distributing cost centers, while the governmental unit might require a modified total direct cost base. If differing bases or methods are imposed upon the subrecipient, dual cost accounting systems will be required. In addition, the use of a combination of bases may result in the over/under recovery of costs. OMB is studying this issue and may promulgate policy requiring consistent application of negotiated rates.

**2-4 Do the Circular A-87 principles apply to the block grant programs?** [Att. A, ¶ A.3]

While the Circular does not apply to many block grants, governmental units should verify the applicability of A-87 with the Federal awarding agency. However, where a governmental unit or component operates both block grants and other Federal programs subject to the Circular, cost allocation plans and indirect cost proposals must be prepared in accordance with A-87 and include the block grants in appropriate bases/cost centers to assure a proper allocation of costs.

**2-5 Does Circular A-87 apply to performance partnerships?** [Att. A, ¶ A.3]

Yes, OMB Circular A-87 applies to performance partnership programs.

**2-6 Attachment A, paragraph B.1 defines different methods constituting Federal "approval." Can this definition be read to mean that approval of an indirect cost rate or state-wide cost allocation plan (SWCAP) represents approval of costs contained by reference in such plans or revisions?** [Att. A, ¶ B.1]

No. This definition only relates to those items that would require prior approval per Attachment B of Circular A-87. It is intended to facilitate the "prior approval" process whereby allocated costs do not require separate approval from every Federal agency affected. In addition, this prior approval concept would not override or make allowable a cost element that is specifically unallowable under another provision of A-87 or program statute. With respect to public assistance cost allocation plans, approval is for methodologies, not costs claimed under such plans.

**2-7 Where prior approval is required for a selected item of cost, how is the approval to be handled where the cost is allocated or distributed to a number of programs/cost objectives?** [Att. A, ¶ B.1]

Where such costs are part of an indirect cost agreement or cost allocation plan, e.g. SWCAP, for which a cognizant agency has been designated, the acceptance of the item of allowable cost by the cognizant agency shall represent prior approval for all Federal

agencies.

**2-8 How can I determine which Federal agency is cognizant for a particular governmental unit? [Att. A, ¶ B.6]**

Appendix 2 is reserved for a future issuance of cognizant assignments pertaining to government agencies and local governments. At the time of this publication, OMB was in the process of revising the current document. The U.S. Department of Health and Human Services is cognizant for all state-wide cost allocation plans. For those entities not listed by OMB, cognizance is generally established based on the Federal agency providing the greatest dollar support that is subject to indirect cost rates.

**2-9 In the revised Circular A-87 issued May 4, 1995, under the provisions concerning "Factors affecting allowability of costs," the prohibition of costs attributable to the routine activities of government has been deleted. Are such costs now allowable? [Att. A, ¶ C.1]**

No. OMB omitted this prohibition under this section because it is now treated as a separate, unallowable cost element under "Selected Items of Cost" — Attachment B, paragraph 23. Such costs continue to be unallowable.

**2-10 In the following examples, would a unit or component of government be in compliance with the "consistency" provisions of Attachment A, paragraphs C.1.e and f? [Att. A, ¶¶ C.1.e, f]**

- (1) **A state with several data processing recharge centers, each using different billing systems and charging bases.**
- (2) **Within a state, one department computes the indirect cost rate using a salaries and wages (S&W) base while another uses modified total direct costs (MTDC).**
- (3) **One department computes a single rate for all divisions versus another that develops multiple rates.**

Depending on the types of programs operated by the various departments and agencies, different methods of allocation may be required to achieve the most appropriate and equitable allocation results. Therefore, the use of different methods for allocating and distributing costs, as described, does not necessarily violate the intent of the A-87 provisions. It is the responsibility of the cognizant agency to assure that the method used in the negotiation and approval process results in the allocation of costs to all activities based on the concept of benefitting program or activity.

**2-11 Circular A-87 stipulates that costs must be consistently treated as direct or indirect under like circumstances. Would this preclude, in the course of direct charging costs, a direct charge being made to an indirect cost center for those costs that are not assignable to a benefitting program, i.e., those that are truly of an indirect nature? [Att. A, ¶ C.1.f]**

No. The requirement in the Circular is to prevent a practice where some of the costs

of a given activity are directly identified to programs/functions while other costs that could have also been charged as direct are treated as indirect. The distribution of a cost grouping or objective must include all benefitting programs/activities in the base, whether they be direct or indirect.

**EXAMPLE:** A local agency, in addition to the Director's Office, has five operating divisions. For its basic telephone service, the agency opts to allocate the bill to organizational units based on the number of telephones in each unit. It must allocate costs to each unit and the Director's Office (which is treated as indirect). It cannot allocate to just two divisions with the other three divisions' allocations being allocated back to the Director's Office.

**2-12 Circular A-87 requires that costs be allocated to activities or cost objectives based on relative benefits received. Are there exceptions to this requirement? [Att. A, ¶ C.3]**

Circular A-87 requires that where a cost or activity benefits multiple activities or programs, those costs must be allocated in accordance with the relative benefits received by each activity or program. This requirement is an underlying principle of cost allocation. Exceptions to this requirement are permissible only under certain circumstances. If an awarding agency determines that costs allocable to another program or cost objective are allowable under their program, then the unallocable costs may be borne by their program. This shifting of unallocable costs is permitted only when the head of the awarding agency advises the cognizant agency that under its enabling legislation, such cost shifting is allowed and expected. In the absence of such authorization, costs must be allocated to all benefitting programs.

**2-13 Some Federal and state programs collect and use identical eligibility criteria or common data such as income, family structure, resources, etc. Can the costs of eligibility determination for several Federal/state programs be assigned to only one program, based on a concept of "primary program"? [Att. A, ¶ C.3]**

Circular A-87 requires that common activities be allocated to all benefitting programs. The notion of "primary program" is contrary to the allocability provisions of A-87. As noted in the answer to Q&A 2-12 above, where the head of an awarding agency determines that the agency's enabling legislation permits reimbursement of unallocable costs, such costs may be allowed by the cognizant official for cost allocation or indirect cost agreements, when notified by the awarding agency head. Absent such notification, the primary program concept may not be used.

**2-14 Sometimes, it is unclear when the costs of one program or activity end and those of another begin. For example, some Federal programs are categorical in nature, requiring some form of cost or beneficiary eligibility determination. In the course of determining that an individual is ineligible for the Federal program, it may be determined that the person qualifies for a state-only program. What criteria are to be used for allocating these costs? Should the Federal program be required to pay for all joint or common costs because, in the course of determining individuals eligible for the program, it follows that some individuals will be determined ineligible as well? [Att. A, ¶ C.3]**

Some states have opted to provide benefits with state funding for individuals not covered by Federal programs. Quite often, in order to achieve economies, states will structure their intake or eligibility processes so that applying and determining eligibility for one or the other program can occur concurrently. As this is an efficient method of serving both programs, for which each receives a common benefit, it is appropriate and proper that each program receive an allocable share of these costs. A typical allocation base would be the number of positive eligibility determinations made for each program. (Such a methodology results in each program receiving a proportionate share of "ineligibility determination" costs.)

Whether such costs can be viewed as being attributable to the activity of determining ineligibility or a common eligibility cost depends on how the state has structured its operations. For example, if an eligibility determination runs its course for the Federal program, and the eligibility process begins anew for the state-only program, then there are costs of determining ineligibility solely for the Federal program. However, where the failure to qualify for the Federal program only requires some incremental work to be performed to determine eligibility for the state-only program (because information and data has been collected for both), then the latter program receives benefit from the common or joint effort previously expended and must receive an allocation of those costs.

In determining whether benefit is received from these common costs, consideration should be given to the following issues: Would the activity still exist, and thereby result in the same costs being incurred, if one program were terminated? Could a reasonable conclusion of eligibility or ineligibility for either program be made if potential beneficiaries were evaluated against certain key eligibility criteria in the early stages of the determination process (i.e., level of income, whether there are children in the home, etc.), rather than at the tail-end of the process?

**2-15 Circular A-87 seems to require that donated services always be allocated indirect costs. Are there any circumstances when such a distribution is not required?** [Att. A, ¶ C.3.b]

As with the distribution of costs to any cost objective, no allocation is required when the component can demonstrate there is no benefit. If the level of benefit is not the same as for other benefitting activities, then additional, intermediate pools would be necessary so that only benefitting indirect costs are distributed to the donated services.

**2-16 The discussion in Circular A-87 concerning allocable costs, Attachment A, paragraph C.3.c, stipulates that costs allocable to one program may not be shifted to another, yet it goes on to say that cost shifting is allowable. Is this inconsistent policy?** [Att. A, ¶ C.3.c]

No inconsistency was intended. OMB made a distinction between *cost allocation* and *funding allocations*. [Editor's note: OMB added the exception language to this provision at the specific request of HHS, to address confusion that had occurred in the funding of some of its programs. The term "cost shifting" should not have been used, because cost shifting is unallowable, per se.] A function or activity within the government organization that benefits two or more programs may be set up as a single cost objective. Costs allocable to that cost objective would be allowable under any of

the involved programs which benefit from these activities/costs. The government can make a business decision regarding what combination of funds made available under these programs would be applied to this cost objective. In public assistance agencies, for example, certain services rendered to children may comprise a cost objective. If the services provided and the criteria establishing the children's eligibility to receive them are the same for two or more child welfare programs, the government could fund the services with any combination of funds made available under these programs. This results in applying eligible funding sources to the single cost objective, rather than allocating the cost objective to the programs involved.

**EXAMPLE:** Program A allows payments for children in foster care whose parents' incomes do not exceed 180% of the poverty income level. The payments to the care givers are matched by the Federal program at 50%, with no ceiling on the total amount that can be paid by the Federal Government. Program B allows payments for children in foster care regardless of the parents' income. While Program B will match these payments at 75%, total Federal payments may not exceed \$10M. The state opts to establish a single cost center for children in foster care whose parents' income is less than 180% of the poverty level. As these children qualify for either program, the state can initially fund these services with the higher matching Program B funds (75%). When the Federal ceiling of \$10M is reached, the cost center can then be *funded*, from that point forward, with Program A funds, albeit at a lower matching rate of 50%. Children whose parents' income exceeds the 180% income level would be charged to a separate cost center, along with the attendant eligibility and other administrative costs. (Typically, the costs of determining eligibility for these two groups would initially be aggregated in an intermediate cost pool reflecting common costs. The pool would be further allocated to the two final cost objectives based on the number of children served in each.)

**2-17 Is the list of applicable credits all inclusive?** [Att. A, ¶ C.4.a]

No. There are other common examples. For instance, applicable credits result from allowable activities that generate income, such as income from sales of publications; income generated from employee morale, health, and welfare activities per Attachment B, paragraph 17; and interest earnings on internal service funds and positive cash flows.

**2-18 If a government operates its entitlement programs through different component units, such as the health department and welfare department, may cost allocation plans be required from each?** [Att. A, ¶ F.2]

Yes. The requirements of Attachment D apply to all public assistance programs, regardless of where they are organizationally located. Public assistance programs are not the only instances when a government component may need a cost allocation plan. Whenever the nature of the component's activities are such that direct costs cannot be adequately determined with reasonable precision, a cost allocation plan would be necessary. Typically, a plan is necessary when substantial "direct" costs of programs,

awards, contracts, projects, etc. consist of joint or common cost distributions. This would not preclude, however, the use of an indirect cost rate in conjunction with a cost allocation plan.

**2-19 Are cost allocation plans only applicable to state/local-wide cost allocation plans (SWCAPs/LOCAPs) and public assistance cost allocation plans (PACAPs)? [Att. A, ¶ F.2]**

No. The component or a Federal agency may request a cost allocation plan in lieu of an IDC rate under the circumstances described for public assistance plans in Q&A 2-18 above. Where a cost allocation plan is necessary for a component of the governmental unit for which the cognizant agency makes no awards, or has no knowledge of the component's programs, the awarding agency impacted the greatest may be designated to approve such plans.

**2-20 Attachment A, Section G discusses the use of a standard 10% rate for services provided by one agency (except state/local-wide centralized services departments) to another within a governmental unit. Can this concept be used under any circumstances where a state makes a subaward to a local government? [Att. A, § G]**

No. This provision only applies to components (agencies) within a specific governmental unit, not outside that unit.

**2-21 Attachment A, Section G allows components, when billing another component for services, to include a flat 10% of salaries and wages in lieu of determining actual indirect costs. Under what circumstances would this be permissible? [Att. A, § G]**

A number of agencies do not receive Federal awards and therefore have no need to obtain an indirect cost (IDC) rate from a cognizant agency. From time to time these agencies might provide a reimbursable service to another agency which does receive awards. OMB opted to allow the 10% of salaries and wages, which is viewed as nominal, rather than requiring such agencies to go through the burden of developing indirect cost rates for relatively insignificant activities. If an agency providing services has an IDC rate, that rate must be used in lieu of the flat 10% rate if its application results in less reimbursement.



# PART 3

## Attachment B — Selected Items of Cost

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### **3.1 Handling Items of Cost Not Listed in Attachment B**

Like other sets of Office of Management and Budget (OMB) cost principles, Circular A-87 lists selected items of cost that are common to performing and administering Federal awards to governmental units. The selection of these costs represents OMB's judgment that policy about allowability is either needed or desirable. However, OMB recognizes that it is not possible to develop comprehensive rules that address every possible type of cost that might arise in the context of awards to governmental entities. Accordingly, Attachment B of the Circular, which addresses the selected items, is introduced with a general policy that is intended to be helpful in making cost determinations. It states: "Failure to mention a particular item of cost in these sections is not intended to imply that it is either allowable or unallowable; rather, determination of allowability in each case should be based on the treatment or standards for similar or related items of cost."

Under this policy, if an item is not listed in the Circular, but a similar item is discussed, it may be that allowability can be determined by assessing the degree to which common characteristics exist between the two cost items. Alternatively, applying the general tests of allowability contained in Attachment A of the Circular could be determinative. It may be advisable to seek advance understanding with the awarding or cognizant agency concerning particular costs if allowability is more difficult to determine, although such a practice is not specifically mentioned in Circular A-87. Other OMB cost principles suggest this approach where doubts are present, but further state that the absence of such an advance understanding does not preclude allowability.

### **3.2 Prior Approval**

In the past, because of concerns about the allocability of certain items of cost, OMB usually required that these items be subject to the prior approval of Federal agencies. The 1995 revision to the Circular changed the frequency and precision with which these approvals must be obtained. First, through definition changes and other means, it streamlined the award administration process by reducing the number of transactions subject to prior approval. Second, it expanded the actual definition of what constitutes approval. Under the new definition, the term "approval or authorization of the awarding or cognizant Federal agency" means "documentation evidencing consent prior to incurring a specific cost." However, the definition goes on to state that if costs are specifically identified in a Federal award document, approval of the document constitutes approval of the costs. If the costs are covered by a state/local-wide cost allocation plan or an indirect cost rate proposal, approval of the plan constitutes the approval of costs requiring prior approval. The addition of these policies in the 1995 revision is intended to preclude prior approval-seeking for costs requiring prior approval when a cost has already been considered and analyzed as part of another review process.

While not specifically mentioned in the Circular, most Federal awards will also identify the official(s) of the awarding agency who are authorized to issue approvals. Approval should always be documented in writing by the authorized Federal official.

### **3.3 Highlights of Changes Affecting Attachment B**

Numerous selected items of cost were added to the listing in the 1995 revision. Many make the Circular consistent with OMB cost principles applicable to other types of recipients. Because of their newness or the relative lack of familiarity that officials of governmental recipients may have with these other cost principles, numerous questions have been raised concerning applicability. Many of these are addressed in the Questions and Answers section which follows the changes listed below.

- Attachment B has been reformatted into an alphabetized discussion of costs, noting in the discussion for each cost whether it is allowable or unallowable. Separate sections dealing with allowability/unallowability have been deleted. Where selected items of cost appear in new sections due to the alphabetical format and there is no substantive change in policy, no mention of the change is provided in this document. Also, as the discussion of allowability for a selected item of cost is applicable regardless of whether a cost is direct or indirect, specific references to billed and like services have been deleted. Again, if no substantive change has been made, no mention is made herein. [Att. B, ¶¶ 1-42]
- Significantly qualifies and defines "advertising and public relations costs" and when they are allowable. [Att. B, ¶ 2]
- Clarifies that "advisory councils" may be allowable as either direct or indirect costs. [Att. B, ¶ 3]
- Adds a new section specifically making alcoholic beverages unallowable. [Att. B, ¶ 4]
- Adds additional language as to what audit costs are allowable and stipulates that they are to be allocated based on the ratio of Federal funds to total expenditures. [Att. B, ¶ 5]
- The specific prohibition of "budgeting costs" attributable to routine costs of government has been deleted from this section. [Att. B, ¶ 9] However, see reference to Att.B,¶ 23, below.
- The section on "Compensation for personnel services" has been greatly expanded. Significant changes are:
  - criteria for determining what is reasonable compensation;
  - an expanded fringe benefits discussion rolled into this section that explains, among other things, how costs are claimed when using accrual or cash basis of accounting;

- considerable attention to the accounting and claiming of pension costs;
  - detailed requirements concerning salary support and time distribution systems; and
  - a new subsection on "donated services" which prohibits reimbursement of such services but nevertheless requires that they be included in the base for purposes of allocating indirect costs. [Att. B, ¶ 11]
- Contingencies continue to be unallowable but the section has been qualified to clarify that reserves for such things as pensions and other fringe benefits are permitted. [Att. B, ¶ 12]
  - A new section, "Defense and prosecution of criminal and civil proceedings, and claims" has replaced the former "Legal expenses" section. The new section incorporates statutorily required language applicable to contracts. Legal and related expenses incurred in the prosecution of claims against the Federal Government remain unallowable. [Att. B, ¶ 14]
  - An expanded section on "Depreciation and use allowances" adds the following provisions:
    - the assets of enterprise funds must be capitalized, as required by GAAP;
    - governmental subdivisions may not be considered donors for purposes of establishing an asset's value at fair market value (FMV);
    - componentization of buildings is allowable;
    - except for enterprise and bona-fide internal service funds, classes of assets must be the same basis as used in the governmentwide financial statements; and
    - when converting from use allowance to depreciation, the balance to be depreciated will be computed using a pro forma depreciation schedule starting with the date of acquisition.

The prohibition of excess capacity has been relocated to another section. (See reference to Att.B, ¶ 24, below). [Att. B, ¶ 15]

- The "Equipment and other capital expenditures" section has been expanded to:
  - define what is a capital expenditure;
  - allow governments to establish a capitalization threshold at the lessor of \$5,000 or the threshold used in preparing the financial statements;

- clarify that capital expenditures may only be allowed as a direct cost with prior approval; and
- provide guidance on how unamortized portions of assets are to be handled when a governmental unit changes its capitalization policy.

Rental costs have been removed from this section and given a dedicated citation. (see 3-22 below) [Att. B, ¶ 19]

- A section on "Fund raising and investment management costs" has been added. Fund raising and general investment activities/costs are unallowable but must be allocated a pro rata share of indirect costs. Investment activities related to pension funds, self-insurance funds, etc. are allowable. [Att. B, ¶ 21]
- A new section has been added addressing gains and losses and the relocation of Federally sponsored programs. While gains and losses on the sale, retirement, or other disposition of depreciable property must be accounted for in the current period, several methods are cited for handling the adjustment. Where Federal programs are relocated from a facility in which there was Federal participation in the financing of the facility, adjustments can be required by the cognizant agency. [Att. B, ¶ 22]
- General or routine costs of government have been given a separate section. In addition to the governor's office, several other examples are listed as being unallowable. [Att. B, ¶ 23]
- A new section addressing idle capacity and facilities was created which incorporates definitions of these terms and establishes parameters for establishing allowability. [Att. B, ¶ 24]
- The section on "Insurance and indemnification" has been expanded to address self-insurance funds such as worker's compensation and unemployment compensation. This discussion is quite detailed and covers such areas as measuring risk, funding, offsets for investment income, etc. [Att. B, ¶ 25]
- Interest is now allowable on equipment acquired before or after the effective date of the revised Circular. However, for existing debt, only interest expense incurred/paid in the government's fiscal year beginning on or after September 1, 1995 is allowable. Retroactive claims for interest paid in prior periods is unallowable. The Circular also requires, for facilities, that earnings on construction borrowings be offset against income expense. Where depreciation and interest expense exceeds principal and interest payments (positive cash flow), the state is required to "negotiate" the amount of allowable interest with the cognizant agency. While no change was made concerning the allowability of interest for facilities, the section now permits interest for reconstruction or remodeling completed after October 1, 1980. [Att. B, ¶ 26]
- A new section on "Lobbying" generally makes these costs unallowable. [Att. B, ¶ 27]

- The section on "Professional services" no longer requires prior approval and has been expanded to include retainer fees. Related to this, the previous requirement that the cost of "management studies" had to have specific prior approval has been deleted. [Att. B, ¶ 33]
- The Circular no longer requires prior approval of "Proposal costs" that are treated as an indirect costs. Prior approval is still required if the cost is claimed as a direct cost. [Att. B, ¶ 34]
- Two new sections have been added addressing "alterations" and "reconversion" costs of facilities. While both are allowable, circumstances dictate whether prior approval is required. Alterations incurred to meet the specific requirements of a Federal award require prior approval. Alterations at the termination of an award that are necessary to restore facilities to their prior condition are allowable. [Att. B, ¶ 36, 37]
- "Rental costs" has been expanded to address capital and less-than-arms-length leases. Allowable costs are limited to the pro forma costs of ownership. [Att. B, ¶ 38]
- The "Taxes" section has been qualified to exclude as allowable those taxes that are self-imposed and otherwise disproportionately affect Federal programs. This qualifier becomes effective on January 1, 1998. [Att. B, ¶ 39]
- Where a governmental unit fails to have written travel reimbursement policies, the "Travel" section now requires that General Services Administration (GSA) rules be used. Where noncommercial air transportation is used, allowable costs are limited to commercial fares. [Att. B, ¶ 41]

### **3.4 Questions and Answers on Attachment B**

#### **3-1 How are the cost allowability requirements of Circular A-87 different from those of Circular A-21 and A-122? [Att. B]**

There are currently some differences between the various sets of OMB cost principles, but they are relatively minor. All three sets of principles reflect essentially the same policies toward cost allowability and documentation. OMB has stated that it intends to eliminate remaining differences as the circulars continue to be revised.

#### **3-2 The previous version of Circular A-87 prohibited budgeting and accounting costs allocable to general costs of government. Are these costs now 100% allowable? [Att. B, ¶ 1]**

No. In its 1995 revision of Circular A-87, OMB omitted language qualifying which accounting and budgeting costs are allowable. Those costs allocable to general or routine costs of government continue to be unallowable under the general provisions of Attachment B, paragraph 23, "General Government Expenses." In its efforts to reduce verbiage in the Circular, OMB determined that it was unnecessary to qualify every item of cost. All costs are subject to the general prohibition of allowing costs attributable to the general cost of government.

**3-3 Other than the capitalization of ADP equipment and related hardware, must the developmental and testing costs for such systems be amortized? [Att. B, ¶ 6]**

At the time of this guide's publication, no applicable industry-wide government accounting standards exist for the treatment of these costs. Governmental units are to treat these costs in accordance with their established capitalization policies. In the future, should the Governmental Accounting Standards Board issue applicable pronouncements on this subject, governmental units will be required to follow them.

**3-4 Where financing was obtained to develop an ADP system, are there any limitations with respect to claiming interest expense associated with these costs?**

Interest is only allowable on capital expenditures where there is interest expense and depreciation (or use allowance) in the current period. If development costs are not amortized, i.e. written off as expenditures, then no interest is allocable or allowable under Federal programs. However, interest expense incurred in the first year of the expenditure is allowable.

**3-5 Lump sum leave (Unused Leave at B.11.d(3)) payments are to be allocated as general administrative expenses to all activities of the governmental unit or component. Why are both noted here, but only "governmental unit" is cited for severance pay (B.11.g(2))? [Att. B, ¶ 11.d]**

The section dealing with severance pay requires an allocation of these costs "to all activities of the governmental unit as an indirect cost." This language is interpreted as including components; no distinction is intended.

**3-6 If an employee worked on the same program during their entire employment, can their unpaid leave, at the time of separation, be charged to that program? [Att. B, ¶ 11.d(3)]**

Attachment B, paragraph 11.d(3) requires that unpaid leave be treated as an indirect cost. If a governmental unit wishes to direct charge such costs, the alternative that would result in the same level of equity would be if unpaid leave for all employees were charged to the source(s) where the leave was earned. The allocation would not only have to be within the last component unit worked, but to all other units worked over the employees' careers. As this approach involves burdensome accounting for the entire work force, OMB provided the indirect cost approach as being the least burdensome.

**3-7 In the preamble to its notice in the May 17, 1995 *Federal Register*, page 26485, OMB stated that a proposed revision requiring separate actuarial computations for different classes of employees had been deleted. OMB did not explain why this provision had been deleted. Does this mean that classes of employees, such as police and social workers, may now be combined for computing pension liabilities and employer contributions? [Att. B, ¶ 11.d(5)]**

No. OMB has stated that this provision was deleted because it was redundant of a more general provision of the final revision to Circular A-87. Attachment B, paragraph 11.d(5) stipulates that fringe benefits must be allocated "in a manner consistent with the pattern of benefits attributable to the individuals or group(s) of employees...." As

such, it is the intent of OMB that separate actuarial analyses be made for pensions and other applicable fringe benefits involving different classes of employees having different cost patterns.

Basic guidelines affecting allowability of costs provide that policies, regulations, and procedures be consistently and uniformly applied to both Federal and nonfederal activities. This consistency concept recognizes that there will probably be several actuarial groupings to reflect different employee classes (e.g., police/fire, judges, regular classified, etc.). Consistency requires that pension contributions for employees within each actuarial grouping be based on the same assumptions and computations (e.g. 7% of salaries and wages).

- 3-8 Circular A-87 states that pension contributions by a governmental unit in excess of the actuarially determined amount for a fiscal year may be used as the governmental unit's contribution in future periods. Does this mean that the excess amount is not allowable in the year contributed, but may be allowed or recognized in future periods? If so, how should the unallowable amount be calculated? [Att. B, ¶ 11.e]**

The maximum amount allowed for pension costs in a given fiscal year would be the amount actually contributed, based on the amount determined for that fiscal year under an acceptable actuarial system that has been used by the government in its financial statements. Any amount exceeding this determination would be unallowable in the year funded but would be considered a prepaid contribution that can be used in whole or in part by the government in a future period when its contribution is less than the actuarially determined amount for that period. The amount allowed in this later period would reflect the amount prepaid, plus interest earnings on that amount, as computed based on the assumed interest rate used by the actuary in its determinations.

- 3-9 Circular A-87 notes only two acceptable methods for computing pension plan costs applicable to a governmental unit's fiscal year, i.e., the pay-as-you-go method or an acceptable actuarial cost method. It further notes the amounts that will be recognized as allowable for a given year, i.e., actual payments to retirees or their beneficiaries under the former method, and amounts funded within six months after the end of that year (extensions subject to approval) for the latter. If another method is used, e.g., an approved funding schedule by the state legislature, is that method acceptable if it produces contributions between what the two approved methods would allow? [Att. B, ¶ 11.e]**

This would be similar to an actuarial method where a governmental unit funds less than the actuarially determined amount. As provided in Attachment B, paragraph 11.e(2), costs that are funded after the six-month period would be allowable in the year the actual funding takes place. However, only the amount that would have been funded if contributions were made on a timely basis would be allowable. Any increased costs due to the delayed funding would be unallowable in the year funded.

- 3-10 Circular A-87 allows recognition of actuarial pension contributions in a specific year if these contributions are made in a period not exceeding six months after year end. An extension of the six months is permitted if an imputed interest offset adjustment is made to compensate for the difference in the timing of the Federal**

**reimbursement versus the state/local contribution. Are such adjustments required during the course of the year, i.e. the timing between the Federal reimbursement during the twelve-month period and the actual contribution to the pension fund during that same period?** [Att. B, ¶ 11.e(2)]

OMB did not believe it was necessary to establish rules concerning timely contributions, as this matter falls under the purview of cash draw downs and, as such, is subject to the provisions of the Cash Management Improvement Act (CMIA) (P.L. 101-453, implemented by the Treasury Department at 31 CFR Part 205). Where the cognizant agency determines that funds have been drawn down, retained for extended periods, and subsequently used to make untimely contributions, the cognizant agency is required to recover imputed interest through the Treasury Department under the auspices of the CMIA.

**3-11 Attachment B, paragraph 11.e(5) provides for the Federal Government to receive a refund, withdrawal, or other credit if pension monies revert to state/local general revenues or other nonpension uses. How would the Federal Government refund be determined?** [Att. B, ¶ 11.e(5)]

The Federal refund percentage of the amount reverted to the governmental unit should be based on the same pro rata share of the pension contribution charged to Federal programs. However, because Federal pension contributions usually occur over a long period of time, an accurate determination of the pro rata share over this period is seldom feasible. The cognizant agency may negotiate with the governmental unit a reasonable estimate of the pro rata share or elect to use the universally accepted 20 percent as the approximation. The 20 percent representing the Federal share would be applied to the total amount transferred.

**3-12 Severance payments associated with normal turnover are allowable and are to be allocated to all activities of the governmental unit as an indirect cost. Are governments required to allocate to the entire governmental unit, e.g. the state, through the state-wide cost allocation plan (SWCAP) as an indirect cost or just to all activities within the affected component of the governmental unit?** [Att. B, ¶ 11.g(2)]

Attachment B, paragraph 11.g(2) only refers to severance pay involved with normal turnover and not that experienced with reductions due to program cutbacks or elimination, reductions in the government workforce, buy-outs, etc. This section deals with relatively insignificant costs resulting from normal operations and are to be included in a component's indirect costs, the SWCAP/LOCAP, or a state/local-wide fringe benefit rate, depending on how the government accounts for such costs. However, they are not to be treated as direct costs.

**3-13 Attachment B, paragraph 11.g(3) notes that "abnormal or mass severance pay will be considered on a case-by-case basis and is allowable only if approved by the cognizant Federal agency." What is the definition of "severance pay" in this case, and what must be submitted to the Federal Government for approval?** [Att. B, ¶ 11.g(3)]

The question raises several points and the responses to each are as follows:



- (1) Mass severance or termination benefits would include all expenses associated with the event. This would include: lump sum payments that may be linked to years of service, increased pension benefits such as granting additional years or eliminating penalties for early retirement, payments of unused leave, and the cost of any other incentive offered to employees as an incentive to leave government service, such as buy-outs.
- (2) The costs of these special termination benefits must be determined and prior approval of such costs must be obtained from the Federal cognizant office prior to claiming these costs directly or indirectly against Federal programs. The requests for prior approval, at a minimum, must demonstrate the reasonableness and allocability of such costs to Federal programs.
- (3) If a state or local government is contemplating such packages, they must obtain approval as required, based on the effective date of Circular A-87 for the specific governmental unit. In addition, even though the former Circular A-87 did not note a specific requirement for advance approval for such costs, it did require that, for claiming and reimbursement purposes, all costs be allocable to and benefit Federal programs.
- (4) Cognizant agencies will generally use the following criteria in making a determination as to whether the abnormal severance costs will be allowed.
  - a. The governmental unit must demonstrate that such costs are allocable to Federal programs.
  - b. The buy-out should be government-wide. (However, see Q&A 3-14 below.)
  - c. The plan should address policies concerning rehiring and forfeiture of buy-out or other severance payments if rehiring policies are not followed.
  - d. The plan should address estimated savings, total and Federal, in both dollars and number of employees.
  - e. The governmental unit should analyze the effect the downsizing will have on the operation, continuity, and effectiveness of programs.
  - f. The governmental unit and the cognizant agency also will establish an agreement providing for compensation to the Federal Government should the terms and conditions of the buy-out/severance plan not be met.

**3-14 Is there a prohibition on allocating or charging buy-out and other severance costs directly to the function or activity in which the employee last worked? [Att. B, ¶ 11.g(3)]**

As stated in Attachment B, paragraph 11.g(3), each incentive package will be

determined on a case by case basis. The direct charging of buy-out costs to functions/programs/components is appropriate under certain circumstances. For example, where the state or the Federal Government is eliminating a program, charging the buy-out costs to that program is consistent with the allocability provisions of Circular A-87. However a problem may be created in this situation because the buy-out costs would be assigned to a component or program that no longer operates. If such programs are state/local-only supported programs, then such costs would not be allocable to Federal programs either directly or indirectly. If such programs are Federally supported programs, then these programs should provide for the costs of such cut backs or terminations because a basic A-87 cost principle at Attachment A, paragraph C.3.c. provides that "[a]ny cost allocable to a particular Federal award or cost objective under the principles provided for in this Circular may not be charged to other Federal awards to overcome fund deficiencies...."

**3-15 What is a personnel activity report (PAR)? [Att. B, ¶ 11.h]**

A PAR is a timesheet or log maintained by the employee which contemporaneously accounts for 100% of their time. The objective is to identify effort spent on multiple activities or programs. Breaks, meals, generic training, etc. can all be coded to a single activity such as "admin" or "other," which in turn would be reallocated to the activities or programs.

In limited situations a PAR can be a time certification relying on an informal log or calendar notations. For example, an attorney working in an agency general counsel office routinely works on general management activities, which are allowable, and his time is charged 100% to an indirect cost center. However, in one month he works three weeks with the state attorney general on a lawsuit against the Federal Government. For that month, it would be acceptable for him to complete an end-of-the-month certification reflecting a 25% distribution of time to the IDC pool and 75% to a cost center representing unallowable legal costs (pursuing claims against the Federal Government).

Caution must be exercised when using time certifications. Their use is only suitable where few activities are involved and the effort involved covers long periods without diversions to other efforts. Where effort is expended on a number of activities with constant variations throughout the day as well as from day to day, a month-end certification would be unacceptable. It would be at best a rough estimate of time expended and would not meet the requirement of an after-the-fact reporting of actual effort.

**3-16 Attachment B, paragraph 11.h establishes acceptable standards for a personnel activity reporting (PAR) system. One standard requires an employee signature when working on multiple activities. If a government component maintains an ADP on-line PAR system which is fully computerized and paperless, would a "digital signature" (occurring when an employee logs on to the PAR system with a logon ID and a secret password) constitute an acceptable alternative to an employee signature? [Att. B, ¶ 11.h]**

As long as the governmental unit can demonstrate and document that only the employees' actions would result in the identification of the activities to be charged, and

that it complies with the other criteria in Attachment B, paragraph 11.h(5), the procedure would be acceptable.

- 3-17 Some central services activities are billed based on the service hours provided to user agencies. Circular A-87 requires that "personnel activity reports or equivalent documentation...must reflect an after-the-fact distribution of the actual activity of each employee." Based on the requirements at Attachment B, paragraph 11.h, are timesheets reflecting actual effort required or are monthly estimates sufficient? [Att. B, ¶ 11.h]**

If an employee is assigned to and expected to work solely in one billed activity (cost objective), only periodic certifications, as required by Attachment B, paragraph 11.h(3), must be generated. However, if that employee is assigned to a billed activity in which multiple rates are developed, then personnel activity reports or equivalent documentation set forth in 11.h(4) and (5) are required. Monthly estimates can only be used for interim billing purposes. Such billings must be adjusted to actual effort based on the criteria set forth in 11.h(5)(e).

- 3-18 How should year-end bonuses be treated? [Att. B, ¶ 11.h]**

If the amounts involved are significant, they must be allocated based on the entire year's activity. As such, time and effort reports (or equivalent systems) must be averaged for the period covered by the bonuses, in this case, an entire year. However, if it can be demonstrated that the time and effort or other statistical data for the period in which the bonus was paid is typical of the entire period for which the bonus was awarded, then no redistribution is required.

- 3-19 If an employee works on only one Federal award, is a certification required? [Att. B, ¶ 11.h(3)]**

Yes. However, this requirement can be met through certain payroll codings and time and attendance certifications pursuant to payroll authorizations. For example, if (1) employees work in a dedicated function; (2) their potential assignment to multiple programs/activities is not within the authority, function, or purview of the supervisor responsible for certifying payroll time and attendance; and (3) the employee is coded to a dedicated function not benefitting multiple functions or programs, the payroll certification shall be accepted in lieu of the semi-annual certification of time and effort.

- 3-20 Will an employee working on two indirect cost activities subject to different allocation bases be required to maintain a personnel activity report? [Att. B, ¶ 11.h(4)(d)]**

Attachment B, paragraph 11.h(4)(d) requires that employees in these circumstances must complete personnel activity reports, whether through time sheets or some form of statistical sampling.

- 3-21 Where a personnel activity reporting system is based on employee time sheets, what are the minimum increments of time in which employees may record their time? [Att. B, ¶ 11.h(5)]**

The purpose of time and effort (T&E) reporting is to capture total activities expended on various Federal and state programs. Depending on the level of detail required by the enabling legislation or management, activity-specific vs. program-specific time might have to be captured. Increments of time should not be limited arbitrarily, because this may prevent employees from accurately and completely reporting effort on all programs and required activities if the minimum increment is too large.

Time sheets must be completed contemporaneously and must be detailed enough to reflect all activities performed during a specific period of time. The time increments should be sufficient to recognize the: (1) number of different activities performed, and (2) dynamics of these responsibilities. For example, very large time increments could be used for employees performing only a few functions which change very slowly over time. Conversely, very small increments would be needed for employees performing a multitude of very short-term tasks.

Reporting time frames established by a unit or component may be subject to Federal review. If the cognizant agency determines that an established time frame or increment is inadequate because it does not allow employees to report effort on all activities or programs fully and contemporaneously, the unit or component will be required to revise its system to capture all activities and programs. To avoid this condition, a statistical reporting system (e.g. random moment sampling) should be considered for employees working in dynamic situations (performing many different types of activities on a variety of programs over a short period of time).

**3-22 For employees working on multiple activities where the component has opted to account for time based on time and effort reports, must the personnel activity report for the employee account for 100% of the worker's effort? [Att. B, ¶ 11.h(5)(b)]**

Yes. Failure to account for 100% of an employee's or volunteer's time would result in the shifting of program/activity costs to those programs for which time is accounted.

**3-23 Can the results of an acceptable statistical sampling method or time and effort reporting covering one period of time be applied to a different period, e.g., a prior quarter? [Att. B, ¶ 11.h(5)(c)]**

No. The results of a specific period represents the values experienced during that period only. Attachment B, paragraph 11.h(5)(c) requires that time and effort reporting coincide with one or more pay periods. Therefore, retroactive application of such results, whether they are statistically based or effort reporting, is unacceptable. However, prior period actuals may be used as estimates for applying costs in a future period, provided that the estimates are adjusted back to actual effort for that period when claimed for reimbursement.

**3-24 How often must time sheets be prepared? [Att. B, ¶ 11.h(5)(c)]**

The timeliness of completing time and effort reports depends on the nature of activities being reported. The Circular requires that such reports must reflect the actual activity of each employee. If activities or programs worked on vary constantly throughout the work day, then they must be completed as each event begins and ends. However, in

accordance with Attachment B, paragraph 11.h(5)(c), they must be completed no less frequently than monthly.

**3-25 Are legal costs associated with administrative appeals of disallowed costs, cost allocation and indirect cost proposal disputes, or other adverse decisions made by the Federal agency allowable? [Att. B, ¶ 14]**

Circular A-87 stipulates that the costs of pursuing claims against the Federal Government are unallowable. However, OMB has deferred to agencies in interpreting this policy. Most, but not all, agencies have interpreted this policy as prohibiting costs associated with both administrative and judicial appeals occurring after a final management decision has been issued by the agency. As efforts are being made to establish a consistent interpretation throughout the Federal Government, governmental units should periodically check with their cognizant or awarding agency to determine if they are affected. Where such costs are interpreted as being unallowable, governmental units must establish methods and a cost center to aggregate such costs.

**3-26 Attachment B, paragraph 14 refers only to those legal defense expenses deemed unallowable. What about accounting or other activities supporting unallowable legal defense activities? [Att. B, ¶ 14]**

Although not mentioned specifically, other costs supporting unallowable legal defense activities would also be unallowable. Unallowable defense activities constitute the cost objective and any costs allocable to that activity are likewise unallowable.

**3-27 How does a governmental unit identify unallowable legal defense and related costs? [Att. B, ¶ 14.b]**

Unallowable activities must be identified through separate cost objectives or cost centers. With respect to salaries and wages, Attachment B, paragraph 11.h(4)(e) requires that unallowable activities be identified through the use of personnel activity reports or equivalent documentation. These costs would be fully burdened with applicable fringe benefits and related administrative costs.

**3-28 Can depreciable lives of assets that are relied upon in the preparation of the financial statements differ from those used in filing claims with the Federal Government? [Att. B, ¶ 15]**

In accordance with the consistency provisions of Attachment A, paragraph C.1.e, if a governmental unit elects to depreciate in its financial statements (CAFR), the depreciable lives and classes used in those statements must be used by all components of the government in their claims under Federal awards.

**3-29 Most states do not have a state-wide policy on depreciation. Quite often, individual state agencies have policies that may be different from state practice, e.g., the state does not depreciate equipment in its financial statements. Are agency policies on depreciation sufficient, if applied consistently throughout the agency, or is the agency required to follow what is practiced by the state in developing its financial statements? [Att. B, ¶ 15]**

OMB recognized that states are not required to depreciate assets in their financial statements. As such, OMB granted an exception to the consistency requirements of Attachment A, paragraph C.1.e. Even if the state financial statements do not provide for depreciation, a government component (e.g. Department of Transportation, public university, etc.) may claim this expense. However, the capitalization threshold used in the CAFR for the fixed asset group must be used by the agency in establishing which assets to depreciate. In addition, depreciable lives for classes of assets must be consistent throughout the component. Where componentization is elected for buildings, the practice must be consistently applied to that asset group throughout the component.

**3-30 Where a governmental unit or component opts to change from use allowance to depreciation, how is this conversion to be handled? [Att. B, ¶ 15]**

In accordance with Attachment B, paragraph 15.e, the asset's imputed book value at the time of conversion is to be established by assessing pro forma depreciation for those periods when use allowance was applicable, i.e. from the date of acquisition. The remaining balance is then depreciated over the remaining useful life.

**3-31 May components of a governmental unit determine, establish, and account for the cost of assets on a different basis, i.e., some through the use allowance provision and others through depreciation? [Att. B, ¶ 15]**

Generally, yes. Attachment B, paragraph 15.a, permits this. However, only one method — depreciation or use allowance — may be applied to a single class of assets. A combination of the two methods is not allowed.

The exception to the above is in the case of internal service funds (ISFs) and enterprise funds. OMB, at Attachment B, paragraph 15.a, recognizes the requirement in generally accepted accounting principles that assets in such funds must be depreciated. The use of a depreciation method in the ISFs is acceptable even though other central service activities (unbilled) are applying use allowance in the determination of their costs.

**3-32 Under what circumstances can accelerated depreciation be claimed? [Att. B, ¶ 15.e]**

Depreciation accounting is, frequently, a reflection of tax or social policy. In contrast to IRS regulations, Circular A-87 follows traditional financial precepts associated with the production of goods and services by requiring that straight line depreciation procedures be applied to recognize an asset's consumption over its useful life (based on historical information or experience). The straight line procedure is presumed to be the only acceptable method because it is extremely difficult to demonstrate that the expected consumption of an asset will be significantly greater in earlier portions of its useful life.

It is assumed that older assets will probably require more maintenance and repair costs than newer assets. However, since these "fix up" costs are recognized as current period expenses, maintenance and repair expenditures have no impact on annual depreciation costs. Depreciation expense might vary from year to year only if an organization could demonstrate that an asset contributes more (or less) each year to the production of

goods and services.

Alternative depreciation procedures may be acceptable if an asset's consumption is based on unit of production rather than estimated useful life. For example, an entity may have a policy of removing vehicles from service after 125,000 miles or replacing certain equipment after 200,000 hours of operation. In these cases, miles driven or operating hours per year could be used to compute annual depreciation (rather than estimated years of service).

**3-33 Under what circumstances may a use allowance be allowed for assets which have been fully depreciated?** [Att. B, ¶ 15.g]

In only the most extraordinary circumstances should a use allowance be allowed for fully depreciated assets. Increased maintenance and service costs resulting from the age of the asset generally are insufficient justifications for allowing use allowance, as such costs are reimbursable directly as current period operating expenses. Furthermore, capital improvements/repairs/renovations to maintain the original asset's viability are equally insufficient justification, as they are recoverable through depreciation. The reimbursement of use allowance may be justified when Federal programs had been charged with little or no depreciation expense in the past.

**3-34 Under what circumstances may a use allowance be allowed for assets which have been subjected to use allowance and would be considered to be fully depreciated at the use allowance rate?** [Att. B, ¶ 15.g]

As with situations where an asset has been fully depreciated, additional use allowance for any asset for which the past application of use allowance can be considered to have resulted in the full acquisition cost of the asset having been recovered, use allowance should only be allowed in exceptional cases. The concept of reasonableness assumes that claims submitted to the Federal Government (and other external organizations) for cost reimbursement should be limited to an asset's acquisition cost. In sum, any claim for cost reimbursement in excess of cost would be unreasonable and unallowable. The criteria for allowing use allowance for fully depreciated assets (see Q&A 3-33) should also be applied for assets that have been subjected to use allowance in the past.

**3-35 Attachment B, paragraph 19.a(2) defines equipment as the lessor of the governmental unit's capitalization policy or \$5,000. However, Attachment B, paragraph 19.d stipulates that items of equipment less than \$5,000 can be charged directly to grants without prior approval of the grantor agency. Do these rules contradict each other?** [Att. B, ¶ 19]

No. Attachment B, paragraph 19.c establishes the requirement for prior approval of capital expenditures. The purpose of Attachment B, paragraph 19.d is to establish the prior approval dollar threshold for capital expenditures charged direct to grants. Attachment B, paragraph 19.a(2) permits governmental units to write-off assets up to \$5,000, pursuant to an established government-wide capitalization policy. Based on these definitions, noncapital expenditures become classified as supplies or some other object of expenditure other than "equipment." However, even if a governmental unit has a capitalization policy of less than \$5,000, they may still claim direct capital expenditures as "equipment" without prior approval, up to \$5,000.

This distinction is necessary to avoid over-reimbursement of indirect costs where a modified total direct cost (MTDC) base is used to distribute indirect costs. When using an MTDC base, the cognizant agency excludes capital expenditures based on the organization's capitalization policy (not to exceed \$5,000). If amounts exceeding the organization's capitalization policy, up to \$5,000, were to be treated as supplies, then indirect costs would be applied to those supplies, resulting in over-reimbursement.

- 3-36 When a governmental unit does not account for depreciation in its financial statements, it theoretically does not have a capitalization policy. On what basis should the governmental unit charge use allowance if it does not have a capitalization policy? [Att. B, ¶ 19]**

Governments that do not report depreciation in their financial statements typically disclose a "fixed asset group." In determining which assets will be reported in this group, the government has established a dollar threshold, i.e., assets costing over a certain amount are included. For purposes of defining equipment and for purposes of charges to Federal programs, the threshold established for the "fixed asset group" would constitute the government's capitalization policy.

- 3-37 Circular A-87 permits governmental units to define equipment up to \$5,000. Assuming a government adopts the \$5,000 limit and purchases a computer system for \$1M, if no single component costs more than \$5,000, can the \$1M be expensed? [Att. B, ¶ 19.a]**

No. The components of the computer system make it useable for the purpose for which it was acquired and therefore establishes the "system" as the capital expenditure. (Att. B, ¶ 19a(1)) In accordance with generally accepted accounting principles, and the definition of "acquisition cost" in section \_\_.3 of the Common Rule accompanying OMB Circular A-102, the entire system of \$1M is to be capitalized. Subsequent additions to the system, such as additional personal computers for new staff, may be treated as maintenance costs expensed to the current period.

- 3-38 A governmental unit does not depreciate capital expenditures but rather expenses everything. For CAFR reporting purposes, however, the unit maintains a fixed asset group category in which all assets over \$250 are tracked as capitalized assets. Which capitalization policy should it use for its central service allocation plan, i.e. \$250 or \$5,000? [Att. B, ¶ 19.d]**

In accordance with Attachment B, paragraph 19.d, the unit is required to use the lesser of \$5,000 or the same capitalization policy used in the development of its financial statements. The capturing of assets over \$250 in the fixed asset group category effectively establishes the unit's capitalization policy at that level. As such, capital expenditures over \$250 may not be expensed in the cost allocation plan. A use allowance may be claimed on those items.

- 3-39 Settlements and damages resulting from noncompliance with Federal, state, or local laws are unallowable. Would settlements with employees arising out of bargaining-unit negotiations and agreements also be unallowable? [Att. B, ¶ 20]**

Provided that no laws have been violated by the governmental unit, such settlements



and awards are allowable as a general management cost.

- 3-40 The Circular stipulates that when there is substantial relocation of Federal projects from a facility in which the Federal Government participated in the financing, space charges may be renegotiated. What criteria are to be used in determining "substantial relocation," and, if there is an adjustment, how should it be handled? [Att. B, ¶ 22]**

The criteria for determining whether a substantial relocation has occurred is if over 50% of Federally sponsored programs are transferred in the first 20 years of occupancy or where a pattern of "churning" Federally financed debt can be established. Cognizant agencies are to exercise caution in exercising the 50% rule, taking into consideration program changes, cutbacks, and the governmental unit's resource needs. Where churning has occurred, i.e. relocations are occurring to maintain Federal programs in debt-financed space, the cognizant agency may limit future space reimbursement to historical costs, i.e. the cost of the vacated space.

- 3-41 Under Attachment B, paragraph 23.a, five examples are presented as unallowable general government expenses. The previous version of A-87 identified others, e.g., accounting and budgeting. Are these latter items now allowable? [Att. B, ¶ 23]**

No, these items are still unallowable when attributable to general government functions. For example, budgeting functions in support of the state legislature, taxing functions of the state treasurer, and criminal prosecutions by the attorney general, are all routine costs of general government and are not allocable to Federal programs.

- 3-42 Attachment B, paragraph 25.e states that severance pay is allowable in the year paid with two conditions, one of which is that the cost is allocated as a general administrative expense to all activities of the government unit. Attachment B, paragraph 11.g also addresses the treatment of severance pay, but makes a distinction between normal turnover and mass severance. Is there a difference between these policies? [Att. B, ¶ 25.e]**

Attachment B, paragraph 25.e only covers normal severance. If severance payments are determined to be abnormal or mass severance, then the provisions at Attachment B, paragraph 11.g(3) must be applied.

- 3-43 Is interest allowed on the acquisition of land that is debt-financed? [Att. B, ¶ 26]**

Yes. However, principal payments for the acquisition of land remain unallowable. The pro rata share of debt payments attributable to land must be deducted from outflows when a cash flow adjustment is required under the provisions of Circular A-87 Attachment B, Paragraph 26. (See Illustration 3-1.)

- 3-44 How is interest expense on assets that have a shorter life than the debt instrument treated? [Att. B, ¶ 26]**

Interest on fully depreciated, scrapped, or nonexistent assets is unallowable. The interest is neither allocable to the asset nor is there an allocable benefit to Federal

programs. In addition, single debt-financing for assets having variable lives must be allocated to those assets. Governments are encouraged to structure their debt in such a way so as not to incur additional financing costs for periods beyond the useful lives of the financed assets.

**EXAMPLE:** A 25-year bond is issued for \$10M. \$7.5M is to be used to construct a facility with a 40-year life and \$2.5M is to be used to acquire equipment with a life of 15 years. Allocable interest would be calculated as follows:

Building: \$7.5M/\$10M	=	75%
Equipment: \$2.5M/\$10M	=	25%

As a result, 75% of annual interest would be allocable to the building, which would be fully allowable in years 1-25. With respect to the equipment, 25% of total annual interest would be allocable and allowable in years 1-15. In years 16-25, when the equipment has been fully depreciated or otherwise out-lived its useful life, 25% of annual interest would be unallowable.

- 3-45 Some governments issue blanket bond issuances to meet their capital needs. Is interest allowable where, in accordance with their capitalization policy, such expenditures are expensed or otherwise not recognized in the comprehensive annual financial report (CAFR) as "fixed assets"? [Att. B, ¶ 26.a]**

No. Expenditures for items expensed or otherwise written-off constitute operating expenditures, unless they are identified as fixed assets. Attachment B, paragraph 26.a only permits interest for capital expenditures. Interest for operating or working capital is unallowable.

- 3-46 Attachment B, paragraph 26.b allows interest on equipment paid or incurred on or after the applicable effective date of the revised Circular (May 4, 1995). However, in the preamble to the May 17, 1995 *Federal Register* notice of the Circular's issuance, page 26486, in response to a comment, OMB seems to exclude computer equipment. Is interest paid or incurred after the applicable effective date allowable? [Att. B, ¶ 26.b]**

In the preamble, OMB was responding to comments that sought allowability of interest on both equipment and facilities, regardless of when the assets were acquired. In justifying allowing interest on pre-effective date equipment, but not facilities, OMB reasoned that, except for computer equipment, such acquisitions typically were nominal in cost and had short lives. The intent was not to exclude computer equipment, but merely to state a fact. As such, interest on all equipment, including ADP, incurred or paid after September 1, 1995 is allowable regardless of when the debt was incurred. For those governmental units or components subject to Circular A-87 Attachments C, D and E, interest on equipment is allowable in the government's fiscal year starting after September 1, 1995. For facilities, interest is only allowable for those acquired or constructed after October 1, 1980.

- 3-47 Attachment B, paragraph 26.b(1) makes interest unallowable when a government**

**borrow from itself or nonbona fide third parties. If the government has established quasi-public agencies or "authorities" to issue bonds for the acquisition of equipment and facilities, are these viewed as less than third-party transactions?** [Att. B, ¶ 26.b(1)]

No. Bond issuing authorities are viewed as enterprises of the governmental unit. The authority typically is not operating at a profit and, as a result, reduces bond issuance costs. While the government is issuing the bonds, it is not borrowing from itself but rather from the general public, to which interest is paid. The intent of this A-87 provision is to prohibit reimbursement of costs such as a state agency borrowing funds from general revenues and the state treasurer charging the agency interest on the borrowings.

**3-48 The Circular requires governmental units to negotiate with the cognizant agency the amount of interest expense to be allowed when depreciation and interest expense (inflows) exceeds principal and interest payments (outflows). Recovering positive cash flows in the early years will result in negative cash flows in the latter years. Doesn't this penalize the governmental unit in later years?** [Att. B, ¶ 26.b(4)]

It is not OMB's intent to require the recovery of positive cash flows. During periods of positive cash flow, earnings, either actual or imputed, can be made on those funds. It is the intent of OMB that during such periods, those earnings on the positive cash flow should be used to offset interest expense. The net amount would be the allowable interest expense allocable to Federal awards. Components would retain the positive cash flow, but not the earnings, to meet shortages during periods of negative cash flow. The interest assessed should be based on actual interest earned or the state treasurer's average return on investment. A suggested format for computing and tracking cash flow is provided in Illustration 3-1.

### Illustration 3-1

## A-87 Excess Cash-Flow Calculation - Sample Format for Annual Report

Applicable for debt arrangements over \$1 million,  
unless initial equity contribution equals 25 percent or more

		<u>Month 1</u>	2	3	<u>4 ***</u>	<u>12</u>	<u>Annual Total</u>
Year _____	of ___ Years						
Line 1	Prior Period's cumulative cash flow balance (Prior Month's or Year's Line 9)						
	Add this period's inflows:						
Line 2	Depreciation expense (Note 1)						
Line 3	Interest expense (Note 2)						
Line 4	Amortization of debt issuance costs (Note 2)						
	Subtract this period's outflows:						
Line 5	Principal payments (Note 3)						
Line 6	Interest payments (Note 3)						
Line 7	Subtotal of cumulative cash flows (Line 1+2+3+4 - 5 - 6)						
Line 8	In initial period only, subtract initial equity contribution (Note 4) (Will be zero after initial period)						
Line 9	Total of cumulative cash flows (In initial period, Line 7 - Line 8) (In subsequent periods, equals Line 7)						
Line 10	If Line 9 is positive, state month's closing interest rate based on actual or state treasurer's ROI If Line 9 is negative, put "0" (zero)						
Line 11	Imputed interest income on cumulative positive cash flow Monthly columns = (Line 10 x Line 9)/12						
Line 12	Allowable interest for period (Line 6 - Line 11)						
Note 1:	May include amortization of capitalized construction interest in accordance with GAAP. Depreciation expenses should be reported on a monthly basis (Annual expense/12) if the agency has an IDC rate.						
Note 2:	Interest expense and amortization of debt issuance costs that are not included in loan amount should be reported on a monthly basis (Annual expense/12) if the agency has an IDC rate.						
Note 3:	If land is included in the financing arrangement, Line 5 would be calculated as: principal payment - (Debt proceeds used to purchase land/total debt proceeds x principal payment). Principal and interest payments should be reported in the month that payments were made.						
Note 4:	This line may only include amounts of initial equity contribution made prior to occupancy of the facility. The amount is to be entered only in the initial period covered by the cash flow submission, and should be left blank in future periods.						

**3-49 The Circular requires an adjustment to interest expense for earnings on positive cash flows. Since the Circular does not specify, how should this be accomplished? Does it apply to all debt? [Att. B, ¶ 26.b(4)]**

While OMB did not provide guidance in Circular A-87, they have been more precise in other circulars on this subject. Circular A-122 and A-21 require that "[t]he 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." Many organizations covered by Circulars A-21 and A-122 typically do not have adequate data to compute return on investments. Consistent with the other Circulars, under A-87, an offset is only required for debt over \$1,000,000.

As noted in Illustration 3-1, the cash flow schedule provides for: (1) a cumulative monthly reporting of cash flows; (2) offset of equity contributions on a "first-in-first-out" (FIFO) basis; (3) waiver of the offset requirement if equity contribution is 25% or more; (4) interest on land but not for principal payments on land; and (5) inflows to be averaged over a twelve-month period, regardless of when actual payments (outflows) are made. While components are not required to use the schedule in Illustration 3-1, cash flow computations and adjustments should be made in accordance with these policies.

**3-50 What type of assets are subject to interest offset for earnings on positive cash flows? [Att. B, ¶ 26.b(4)]**

OMB advised HHS that it intended that all capital expenditures be subject to the offset provision, where applicable. This is consistent with the other OMB cost circulars.

**3-51 What are the submittal requirements for the cash flow analysis? [Att. B, ¶ 26.b(4)]**

When required by the cognizant agency, the cash flow analysis is to be submitted with each submission of a component's indirect or cost allocation proposal. The analysis is to be prepared for each twelve-month period contained in the proposal. For those governments and components not required to submit a proposal to a cognizant agency, the analysis is to be prepared annually with a corresponding adjustment to allowable interest for the period.

**3-52 Is it acceptable to treat proposal costs for Federal awards as indirect costs? [Att. B, ¶ 34]**

Attachment B, paragraph 34 encourages such treatment. In accordance with Attachment A, paragraph C.1.e, the practice must be consistently applied throughout the governmental unit. The Circular allows the direct charging of these costs with the prior approval of the awarding agency. This practice is discouraged as it may create inconsistent treatment issues.

**3-53 What are the allowable costs for capital leases? [Att. B, ¶ 38.d]**

The Circular provides that capital leases are allowable to the extent that costs would have been allowed had the asset been purchased outright. As such, interest, depreciation or use allowances, maintenance fees/expenses, related administrative costs, taxes, and insurance are allowable. Interest costs are allowable to the extent they meet the requirements of Attachment B, paragraph 26. Unallowable costs include amounts paid for profit, management fees, and taxes that would not have been incurred had the government/component purchased the asset outright.

**3-54 Are "payments in lieu of taxes" (PILOT) allowable? [Att. B, ¶ 39]**

Generally, PILOT payments are allowable if they are consistently assessed against all activities, regardless of the source of funding.

**3-55 If a governmental unit has its own plane(s), what documentation is needed to satisfy the Circular A-87 requirements for noncommercial travel? Can the cognizant agency approve rates for the aircraft that would meet these requirements? [Att. B, ¶ 41.d]**

Attachment B, paragraph 41.d. limits reimbursement for use of entity-owned or private aircraft to the commercial air fare determined in accordance with Attachment B, paragraph 41.c, which discusses limitations on allowable commercial air fares. In essence, reimbursement for use of private aircraft is based on cost but cannot exceed what would have been reimbursed had commercial air transportation been used. There could be circumstances where the use of commercial air would result in greater costs than the use of private aircraft. In those situations, allowable costs would be based on actual costs.

# PART 4

## Attachment C — Requirements for Cost Allocation Plans

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### 4.1 Highlights of New Section, Attachment C

A new attachment C has been added addressing Central Service Cost Allocation Plans (commonly referred to as the state-wide cost allocation plan or SWCAP and for local governments, LOCAP). The new Attachment generally has incorporated longstanding practices and procedures contained in internal HHS implementing material as well as historical convention.

### 4.2 What is a Central Service Cost Allocation Plan?

Most governmental units provide certain services, such as motor pools, computer centers, purchasing, accounting, etc., to operating agencies on a centralized basis. Because Federally supported awards are performed within the individual operating agencies, there needs to be a process through which these central service costs can be identified and assigned to benefitted activities on a reasonable and consistent basis. The central service cost allocation plan (CSCAP) provides that process.

### 4.3 Content of CSCAPs

CSCAPs must include all central service costs that will be claimed, whether as a billed or an allocated cost, under Federal awards. Costs of central services omitted from the plan **will not** be reimbursed. Documentation requirements are discussed in section 4.5 below.

Plans must include a projection of the next year's allocated central services cost. This projection should be based on either actual costs for the most recently completed year or the budget projection for the coming year. Plans must also include a reconciliation of actual allocated central services costs to the estimated costs used for either the most recently completed year or the year preceding the most recently completed year.

### 4.4 Requirements for Submission of Cost Allocation Plans

#### 4.4.1 Role of Cognizant Agencies

Circular A-87 provides that, for certain larger governmental units and their subdivisions, Federal cognizant agencies will be appointed to review and approve cost allocation plans on behalf of other Federal agencies. The Circular further explains these assignments and the approval process that these agencies will use.

#### 4.4.2 State Governments and "Major" Local Governments

All state governments must submit statewide cost allocation plans to the Department of Health and Human Services. All local governments that OMB designates as "major" are also required to submit their plans to a designated cognizant agency unless the

cognizant agency determines otherwise. Note: Indian tribal governments should use guidelines applicable to local governments and local education agencies (LEAs) should follow the procedures established by the U.S. Department of Education.

OMB periodically publishes a listing of major local governments in the *Federal Register*. The most recently published listing is contained in Appendix 2 of this guide. In general, cognizant agencies for local governments are assigned according to the predominance of Federal funding, although other factors such as availability of resources and past history may also be considered.

#### **4.4.3 Local Governments Not Considered "Major"**

Local governments that are not designated as "major" are not required to submit their cost allocation plans for Federal review and approval unless specifically instructed to do so by a Federal agency. Local governments that only receive funds as a subrecipient of another government should follow instructions from their pass-through grantors concerning submission and review. However, they are expected to prepare and retain their plans for audit by independent auditors and Federal auditors. Pass-through grantors (primary recipients) are expected to review and monitor subrecipient plans to provide reasonable assurance that provisions of Circular A-87 are being followed.

#### **4.5 What Are the Documentation Requirements for a CSCAP?**

All costs and other data used to distribute the costs included in the plan should be supported by formal accounting and other records that will support the appropriateness of the costs assigned to Federal awards.

##### **4.5.1 Allocated Central Services**

The allocated costs of the CSCAP are commonly referred to as "Section I" costs and are categorized as such in both the plan submission and the negotiated agreement. For each allocated central service, the proposed cost allocation plan must:

- briefly describe the service;
- identify the unit rendering the service and the operating agencies receiving the service;
- list the items of expense included in the cost of the service;
- identify the method used to distribute the cost of the service to benefitted agencies; and
- provide a summary schedule showing the allocation of each service to benefitted agencies.

In addition, all proposed cost allocation plans must be accompanied by:

- an organization chart which is sufficiently detailed to show operations, including the central service activities of the governmental unit, regardless of whether they are shown as benefitting from central service functions;



- a copy of the comprehensive annual financial report (CAFR) (or executive budget, if budgeted costs are being proposed) to support the allowable costs of each central service activity included in the plan; and
- a certification that the plan:
  - was prepared in accordance with A-87;
  - contains only allowable costs; and
  - was prepared in a manner that treated similar costs consistently among the various Federal awards and between Federal and nonfederal awards/activities.

#### **4.5.2 Internal Service Funds**

The internal service funds (ISFs) and other billed services in the CSCAP are commonly referred to as "Section II" costs in both the plan submission and the negotiated agreement. For each internal service fund or similar activity with an operating budget of \$5 million or more, the proposed cost allocation plan must include:

- a brief description of each service;
- a balance sheet for each fund based on individual accounts contained in the governmental unit's accounting system;
- a revenue/expenses statement with revenues broken out by source;
- a list of nonoperating transfers (as defined by generally accepted accounting principles) into and out of the fund;
- a description of the methodology used to charge the costs of each service to users, including how billing rates are determined;
- a schedule of current rates; and
- a schedule comparing total revenues (including imputed revenues) generated by the service to the allowable costs of the service under Circular A-87, with an explanation of how variances will be handled.

#### **4.5.3 Self-Insurance Funds**

For each self-insurance fund, the proposed cost allocation plan must include:

- the fund balance sheet;
- a statement of revenue and expenses, including a summary of billings and claims paid by the agency;
- a listing of all nonoperating transfers into and out of the fund;

- the type(s) of risk(s) covered by the fund;
- an explanation of how the level of fund contributions are determined;
- a description of the procedures used to charge or allocate fund contributions to benefitted activities;
- an identification and explanation of reserve levels in excess of claims:
  - submitted and adjudicated, but not paid;
  - submitted but not adjudicated; or
  - incurred but not submitted; and
- an insurance report.

#### **4.5.4 Fringe Benefits Costs**

For fringe benefit costs, the proposed cost allocation plan must:

- list fringe benefits provided to covered employees and the overall annual cost of each type of benefit;
- identify current fringe benefit policies; and
- describe procedures used to charge or allocate the costs of the benefits to benefitted activities.

#### **4.5.5 Pension and Postretirement Health Insurance Plans**

For pension and postretirement health insurance plans, the proposed cost allocation plan must provide:

- the governmental unit's funding policies, if different from actuarially determined rates;
- the pension plan's costs accrued for the year;
- the amount funded and date(s) of funding;
- a copy of the current actuarial report, including the actuarial assumptions;
- the plan trustee's report; and
- a schedule from the activity showing the value of the interest cost associated with late funding.

#### **4.5.6 Certification**

CSCAPs must be accompanied by a certification, shown in Attachment C, ¶ D.4. (See also 2.9, Government Certification)

## **4.6 How Should Allocated Costs Be Presented in a CSCAP?**

### **4.6.1 Sample Formats for Central Service Cost Allocation Plans**

The following pages illustrate a central service cost allocation plan. They consist of:

Illustration 4-1 - Statement of Function and Benefit, Personnel Department. The personnel department has been selected as an example of a central service. This schedule is a narrative description of the activities conducted by the personnel department, their necessity (benefits) to the successful performance of Federally supported programs, a description of the base(s) selected to distribute the costs of those activities to the organizations to which services are rendered, and the rationale for the base(s) selected.

Illustration 4-2 - Costs to be Allocated, Personnel Department. This illustration shows the composition of the costs of the personnel department as contained in official financial or budget statements and a reconciliation of those costs with the amount allocated in Illustration 4-1.

Illustration 4-3 - Allocation of Costs, Personnel Department. This illustration shows those state organizations to which the personnel department provides services and the allocation of its costs to those organizations. This illustration is supported by Illustrations 4-1 and 4-2.

Illustration 4-4 - Summary of Allocated Central Service Costs. This illustration shows each central service, and the attendant costs, which benefit Federal grants and contracts and for which a state or local government wishes to make a claim. This summary must be supported by detailed schedules comparable to Illustrations 4-1 — 4-3 for each included central service. (For purposes of preparing Attachment A of the Negotiation Agreement, only those state agencies receiving Federal funds are to be individually listed. The remaining agencies are to be grouped under "other.")

Illustration 4-5 - Summary of Central Services Billed. It is common practice for central service departments to bill those organizations to which they render services for the cost of those services. This summary illustrates the services billed to organizations conducting Federal grants and contracts, the costs included in the billing, the methodology for computing the billing rate, etc.

Amounts allocated to the operating departments from the central service cost allocation plan in Illustrations 4-4 and 4-5 are carried forward to Illustrations 6-1 — 6-4, which provide various sample formats for an indirect cost rate proposal.

Only a few of the many possible central services have been shown in Illustration 4-4 and only one central service department is shown in the accompanying Illustrations 4-1 through 4-3. A central service cost allocation plan may include any other services and their attendant costs which are allowable under OMB Circular A-87 and for which documentation can be provided. Each type of cost claimed should be supported by appropriate schedules and other documentation sufficient to provide a reasonable basis for evaluation and acceptance.

## Illustration 4-1

### **Sample Central Service Cost Allocation Plan Statement of Function & Benefit, Personnel Department For the Fiscal Year Ended June 30, XXXX**

The personnel department is responsible for overall administration of the Civil Service program. This includes recruiting, interviewing, testing, and referring potential candidates for the more than 2,000 municipal positions.

The personnel department administers the classifications and salary programs and is responsible for recommending personnel policies and procedures to the Civil Service Commission for approval.

The department is involved in the design of the various employee benefit programs. After installation, the department reviews and maintains the records of these programs.

Active and inactive personnel records are maintained on all municipal employees.

The personnel department is responsible for maintaining the safety program (including workmen's compensation and injury level) and the city training programs.

All functions and services performed by the personnel department benefit all departments of the city. Federal programs are benefitted because city employees are hired to work in these programs. Therefore, the costs of the personnel department have been distributed to all departments of the city.

The basis for allocation is the number of employees per department. The base data is readily available and verifiable. All employees receive essentially the same type and level of services. Therefore, this base reflects that condition by distributing the total cost of providing these services to each department in proportion to its relative number of employees.

This is a sample. In practice, this schedule should be sufficiently detailed to provide narrative explanations of the functions and benefits associated with the costs being allocated.

**Illustration 4-2**

**Sample Central Service Cost Allocation Plan  
Costs to be Allocated, Personnel Department  
For the Fiscal Year Ended June 30, XXXX**

Salaries and Wages	\$1,088,380
Fringe Benefits (19.8%)	215,499
Supplies	113,600
Travel	26,200
Equipment/Capital Outlay	41,560
Maintenance and Janitorial Services	26,040
Miscellaneous	<u>35,880</u>
Total Cost	\$1,547,159
Adjustments	
Less: Unallowable Costs	<40,979>
Capital Outlay	<41,560>
Costs Chargeable to Federal Grant (a)	<24,000>
Add: Use Allowance	<u>15,236</u>
Subtotal Adjustments	<u>&lt;91,303&gt;</u>
Total Allowable, Allocable Costs	<u>\$1,455,856</u> (b)

**Notes:**

- (a) Represents charges to a Federal grant awarded to assist the state or local government in improving its efforts to hire and train disabled workers. If a supporting agency received an award from the Federal Government, all costs incurred in connection with the award (including any costs that are required for matching or cost sharing) must be eliminated prior to distributing the supporting agency's costs to the user departments or agencies.
- (b) The costs allocated must be reconciled to appropriate financial documents, either financial statements, budgets, or a combination of both. In this example, the government's base data was cost incurred for its most recent fiscal year.

This is a sample. In practice, this schedule should be sufficiently detailed to show the costs of major activities, branches, etc. of the personnel departments in a manner permitting a reasonable assessment of the costs claimed against Federal programs.

### Illustration 4-3

#### Sample Central Service Cost Allocation Plan Allocation of Costs, Personnel Department For the Fiscal Year Ended June 30, XXXX

<u>Department/Unit</u>	<u>Number of Employees (b)</u>	<u>Percent</u>	<u>Allocation (c)</u>
Health	188	6.61	96,232
Environmental Services	170	5.98	87,060
Social Services	61	2.14	31,155
Highway and Public Transportation	289	10.16	147,915
Police	570	20.04	291,754
Corrections	475	16.70	243,128
Other Departments (a)	<u>1,091</u>	<u>38.37</u>	<u>558,612</u>
Total	<u>2,844</u>	<u>100.00</u>	<u>\$1,455,856</u>

**Notes:**

- (a) Those departments that do not perform Federal programs may be grouped together. However, a one-time schedule is required, listing all agencies or functions listed under "other."
- (b) Allocation base must include all full- and part-time employees of all operating departments that are serviced by the personnel department.
- (c) Allocated amounts are carried forward to the summary schedule in Illustration 4-4. The total of \$1,455,856 comes from Illustration 4-2.

This is a sample. In practice, the type and level of service provided by the personnel department to the various organizations served may require a separate allocation for each service or to different organizations served.

## Illustration 4-4

### Sample Central Service Cost Allocation Plan Summary of Allocated Central Service Costs For the Fiscal Year Ended June 30, XXXX

Department/Operating Unit	Central Service Organizations (c)				Total Allocated Costs (b)
	Personnel (a)	Accounting/ Cmptr Svcs.	Purchasing	Audit	
Health	96,232	201,450	34,123	16,753	348,558
Environmental Services	87,060	216,220	22,211	12,210	337,701
Social Services	31,155	79,841	8,960	6,452	126,408
Highway and Public Transportation	147,915	428,550	67,512	62,271	706,248
Police	291,754	519,605	94,751	114,211	1,020,321
Corrections	243,128	497,431	99,970	145,260	985,789
Other Departments	<u>558,612</u>	<u>1,876,082</u>	<u>214,311</u>	<u>186,542</u>	<u>2,835,547</u>
TOTALS	<u>\$1,455,856</u>	<u>\$3,819,179</u>	<u>\$541,838</u>	<u>\$543,699</u>	<u>\$6,360,572</u>

**Notes:**

- (a) Allocated amounts shown are from Illustration 4-3. In an actual plan, the remaining service departments would also need to be supported by separate schedules showing the computation of the allocated amounts.
- (b) These amounts are includable in the indirect cost proposals of the individual operating departments/units. See Illustrations 6-1 — 6-4.
- (c) Suggested allocation bases can be found in Section 4.6.2.

This is a sample. In practice, a state or local government may wish to claim more or fewer activities as charges to Federally supported programs. If so, this Illustration and its supporting schedules (Illustrations 4-1 — 4-3) would need to be modified accordingly.

## Illustration 4-5

### Sample Central Service Cost Allocation Plan Summary of Central Services Billed to User Organizations

**Motor Pool** The state (or local government) operates a central motor pool which makes cars, trucks, and buses available to the user departments. User departments are billed for each mile driven: cars - 40 cents per mile; trucks - 55 cents per mile; and buses - 75 cents per mile. The basis for the charge is the most recent study of cost per mile driven, performed by the internal audit staff. Any over- or under recovery is applied to the next year's expected expenditures and is included in that year's billing rate. The costs included are salaries and wages and fringe benefits of motor pool personnel; their travel; supplies and parts; and use charges for equipment, buildings, and vehicles determined in accordance with OMB Circular A-87.

**Data Processing** The state (or local government) operates a central data service center (DSC) consisting of a mainframe computer and an area network. The center provides both regular, continuing, and special job computer support to most operating and staff departments. Billings for services are made to user organizations based on a standard price schedule. The price schedule is related to, and designed to recover, the costs of various types of jobs on each system. It is revised quarterly and audited annually by the internal audit department. Profits or losses are carried forward and used to adjust price schedules of ensuing quarterly billing rates. Costs consist of salaries and wages and fringe benefits of center personnel, supplies, maintenance and utilities, and straight-line depreciation of equipment based on a fifteen-year life.

This is a sample. In actual practice, a complete listing of all billed components of the DSC would be required: e.g., CPU, programming, microfiche, etc.

**Long Distance Telephone** All long distance telephone calls are placed through a central switchboard and are billed to the organizations making the call.



**Notes:**

If a direct billing mechanism is used by the government, then all users must be billed, either through actual, memo, or imputed billings. Billing of selected departments and allocation of residual amounts through the cost allocation plan to remaining departments results in inequitable costing and is not acceptable. However, if all users are billed, residual amounts may be allocated through the allocation plan, provided they are not material and the allocation base is equitable.

A detailed breakdown of costs is not normally required as a part of this summary. However, the submitting state or local government must have and make available to the Federal cognizant agency such cost and revenue breakdowns, utilization records, and other information necessary to permit a reasonable assessment of the costs incurred and changes made.

This is a sample. In practice, the number and types of services billed may be greater than shown here and may require more extensive description and explanation.

#### 4.6.2 Suggested Bases for Cost Distribution

Listed below are suggested bases for distributing joint costs of central-type services to local government departments or agencies and to projects and programs utilizing these services. The bases are suggestions only, and should not be used if they are not suitable for the particular services involved. Any method of distribution can be used which will produce an equitable distribution of cost. In selecting one method over another, consideration should be given to the additional effort required to achieve a greater degree of accuracy.

<i>Type of Service</i>	<i>Suggested Bases for Allocation</i>
Accounting	Number of transactions processed
Auditing	Direct audit hours
Budgeting	Direct hours of identifiable services of employees of central budget
Buildings lease management	Number of leases
Data processing	System usage
Disbursing service	Number of checks or warrants issued
Employees retirement system administration	Number of employees contributing
Insurance management service	Dollar value of insurance premiums
Legal services	Direct hours
Mail and messenger service	Number of documents handled or employees served
Motor pool costs, including automotive management	Miles driven and/or days used
Office machines and equipment maintenance repairs	Direct hours
Office space use and related costs (heat, light, janitorial services, etc.)	Square feet of space occupied
Organization and management services	Direct hours; Square feet
Payroll services	Number of employees
Personnel administration	Number of employees
Printing and reproduction	Direct hours, job basis, pages printed, etc.
Procurement service	Number of transactions processed
Local telephone	Number of telephone instruments
Health services	Number of employees
Fidelity bonding program	Employees subject to bond or penalty amounts

#### **4.7 How Should Billed Costs Be Presented in a CSCAP?**

"Billed costs" include internal service funds (ISFs), self-insurance funds (SIFs), and fringe benefits funds (FBFs). Illustrations 4-6 and 4-7 show suggested formats for presenting these costs in the CSCAP proposal. While these formats are not mandated, the information they contain is required, unless the cognizant agency waives the requirement.

Specifically, for all funds, including those under \$5 million, a schedule of retained earnings (see e.g., Illustration 4-7) must be submitted which shows:

- the beginning balance for the fiscal year;
- actual and imputed revenues;
- A-87 allowable costs, adjusted for:
  - capital expenditures,
  - depreciation or use allowance,
  - nonrecognized transfers,
  - bad debts,
  - CSCAP allocations,
  - actual or imputed earnings on monthly cash balances and replacement reserves;
- working capital reserve; and
- contributed capital.

Contributed capital consists of unallowable A-87 costs, such as reserves for future asset replacement and capital expenditures, and are funded by nonfederal funds.

For those funds which have operating budgets over \$5 million, a schedule of billed services must be submitted. Illustration 4-6 is a suggested format for presenting billings. Again, this format is only for illustration purposes, and is not required. However, the schedule must provide, for each fund:

- billings by user;
- revenues, both actual and imputed; and
- adjustments for the pro rata share of the rate representing bad debts, reserves for replacement costs, capital expenditures, etc.



## Illustration 4-7 Reconciliation of Retained Earnings

STATE OF \_\_\_\_\_

FUND

ATTACHMENT B

RECONCILIATION OF RETAINED EARNINGS BALANCE TO FEDERAL GUIDELINES  
FOR YEAR ENDING JUNE 30, 19\_\_

**PART I A-87 R.E. BALANCE**

(000s)

A-87 R.E. BALANCE JULY 1, 19__								
Balance Per Prior Year's Reconciliation of Fund to A-87						\$0		
(Initial Year, Use CAFR RE Balance at Beginning of Year Less								
Adjustments - e.g., Contrib, Capital)								
FY 19__ RETAINED EARNINGS INCREASE (DECREASE) Per CAFR								
A-87 Revenue (Actual and Imputed)								
From Attachment A					\$0			
Other-					0			
Total Revenues						\$0		
Expenditures (Actual Costs):								
Per State's Financial Report						\$0		
Less A-87 Unallowable Costs (e.g.)-								
Capital Outlay					(0)			
Projected Cost Increases/Replacement Reserve					(0)			
Bad Debt					(0)			
Other - (e.g., Gain on Disposal of Assets)					(0)			
Plus A-87 Allowable Costs (e.g.)-								
Indirect Costs from SWCAP					0			
(If Not Allocated in Section I Of SWCAP To User Depts/Programs)								
Depreciation or Use Allowance					0			
(If Not Included in Actual Costs Above)								
Other-					0			
OMB A-87 Allowable Expenditures						\$0		
Adjustments:								
Imputed Interest Earnings on Monthly Average Cash Balance								
at State Treasury Avg. Rate of Return					0			
Other-					0			
Total Adjustments						\$0		
A-87 R.E. BALANCE June 30, 19__	(A)							<u>\$0</u>
Allowable Reserve	(B)					\$0		
Excess Balance (A)-(B)								<u>\$0</u>
(If less than zero, the amount on (A) is the beginning A-87 R.E. balance for the next year's reconciliation. If there is an excess balance, than the federal share should be returned to the federal gov't and the amount on (B) will be the beginning A-87 R.E. balance for the next year.)								

**PART II A-87 CONTRIBUTED CAPITAL BALANCE**

A-87 CONTRIBUTED CAPITAL BALANCE JULY 1, 19__								
						\$0		
TRANSFERS Per CAFR (Supported By Official Accounting Records)								
Plus: Transfers in (e.g., Contrib. Capital)						\$0		
Less: Transfers Out (e.g., Payback of Contrib. Capital, Other Users of Fund R.E.)						(0)		
Net Transfers								\$0
A-87 CONTRIBUTED CAPITAL BALANCE JUNE 30, 19__	(C)							<u>\$0</u>

**PART III A-87 ADJUSTMENTS BALANCE**

A-87 ADJUSTMENTS BALANCE JULY 1, 19__								
ADJUSTMENTS:								
Less: A-87 Unallowable Costs						(\$0)		
Plus: A-87 Allowable Costs						0		
Other-						0		
Total Adjustments								\$0
A-87 ADJUSTMENTS BALANCE JUNE 30, 19__	(D)							<u>\$0</u>

**PART IV RECONCILIATION OF A-87 R.E., CONTRIBUTED CAPITAL AND ADJUSTMENTS BALANCES TO CAFR BALANCE**

RECONCILIATION OF A-87 R.E., CONTR. CAPITAL & ADJUST. BALANCES TO CAFR (A) + (C) + (D)								
(Should Tie to the Fund Balance in the CAFR)								<u>\$0</u>

## **Instructions for Preparing the Reconciliation of Retained Earnings (R.E.) Balance to Federal Guidelines (Illustration 4-7)**

**General.** A reconciliation schedule must be completed for all billed central services, including internal service funds (ISFs), self-insurance funds (SIFs), and fringe benefit funds (FBFs).

For those funds which utilize multiple billing rates (e.g., ADP funds), a reconciliation schedule may be required for **each** billing rate. An overall/average fund balance may not be appropriate, because excess charges may occur in one billed service but undercharges may occur in other billed services. In addition, various users do not utilize each/all billed services to the same extent.

### **Part I A-87 R.E. Balance**

1. **Beginning A-87 R.E. Balance.** If this is the first time the reconciliation schedule is being prepared, the beginning A-87 R.E. balance should be the R.E. balance on the state's CAFR, including allowable adjustments (e.g., transfers in/transfers out, A-87 unallowable/allowable costs, imputed interest). If the fund has been reviewed in prior years, the beginning balance will be the ending balance from the previous year's reconciliation schedule. However, if adjustments for excess reserve balances have been made, then a zero balance may be the appropriate starting balance.
2. **A-87 Revenues.** Revenues shall consist of all revenues generated by the service, including unbilled and uncollected revenues. If some users were not billed for services (or were not billed at a full rate), a schedule showing the full imputed revenues associated with these users shall be provided (see Summary of Actual and Imputed Revenues - Illustration 4-6). Revenues should also include (i) all other revenues the fund earned from its operation, and (ii) interest earned on reserves. If imputed interest/investment earnings are shown at the bottom of the schedule, these amounts should not be included in this section.
3. **A-87 Expenditures.** The initial expenditure balance should reconcile to the CAFR (or other financial records). Adjustments in accordance with A-87 are made, for example, the exclusion of bad debts and the inclusion of allocated central service costs (SWCAP Section I costs).
4. **Imputed Interest.** There are different methods to compute imputed interest earnings. Currently, one acceptable method is the application of the state's Treasury Average Rate of Return to the monthly average cash balance for the year. If actual interest earned is computed incorrectly, then additional interest may be imputed.
5. **Allowable Reserves.**
  - A. **Internal Service Funds.** The allowable reserve for ISFs, which are identified in the CAFR, is equal to the ISF's billing cycle up to 60 days allowable operating expenditures. The reserve is determined by applying a percentage to the allowable operating expenditures (excludes depreciation/use allowance, start-up capital, and any reserves to fund

long-term assets). The percentage is the number of days in the billing cycle days divided by 360.

Reserves for other billed central services that are not identified as ISFs in the CAFR are unallowable.

B. **Self-Insurance Funds.** The allowable reserve for self-insurance funds is defined in Circular A-87, Attachment B, paragraph 25. d. It is normally limited to the discounted present value of claims (i) submitted and adjudicated but not paid; (ii) submitted but not adjudicated; and (iii) incurred but not submitted.

C. **Fringe Benefit Funds.**

(i) *Medical, Unemployment, and Workers' Compensation Insurance.* See self-insurance funds above.

(ii) *Pension Plan.* Actuarial determined, but limited to the amount funded in accordance with Circular A-87, Attachment B, Paragraph 11.e.

(iii) *Post-retirement Health Benefits.* Actuarial determined, but limited to the amount funded in accordance with Circular A-87, Attachment B, paragraph 11.f.

(iv) *Accrued Leave.* Accrued leave is the amount required to pay leave earned but not taken. The reserve must be a valid liability as defined by GAAP and is limited to the amount funded. It must be supported by the state's payroll records.

Note: To be considered funded, a reserve must be paid to a trustee (or insurer) who maintains a trust fund or reserve for the sole purpose of paying the specific fringe benefit for which the reserve is established. If there is no funding, costs are recognized when paid.

6. **Excess Balance.** The Federal share of the excess must be returned to the Federal Government. Exceptions are based on negotiator judgment. For example, the state could credit the appropriate Federal and state programs/agencies for the overcharged amount, or the future billing rates could be reduced.

Interest may be assessed, taking into consideration the time period required to affect the payback.

## **Part II A-87 Contributed Capital Balance**

1. **Transfers In/Transfers Out.** Contributed capital represents contributions by the state to the fund to cover expenditures not allowable under A-87, capital expenditures, reserves for the acquisition of future assets, etc. Transfers in/transfers out are identified in the CAFR and are in compliance with GAAP. Examples include contributed capital to the fund by the state or the transfer out of earned capital/cash to a fund that is having cash flow problems.

### **Part III A-87 Adjustments Balance**

1. **A-87 Adjustments.** Adjustments specific to A-87 must be identified and recorded. The figures should be the same as those identified in Part I above.

### **Part IV Reconciliation of R.E., Contr. Capital & Adjustments Balances to CAFR Balance**

1. The ending balances for Parts I, II, and III are totaled. The total figure should reconcile to the CAFR fund balance.

Note: If this schedule is for a billed central service that is general funded (and not identified as an ISF in the CAFR), there will be no reconciliation.

### **4.8 Questions and Answers on Attachment C**

- 4-1 Under what, if any, circumstances can an approved cost allocation plan be reopened by either party? [Att. C]**

With respect to the governmental unit or component, the only circumstance whereby a negotiated plan can be re-opened is noted in Question 4-2 below. The basis for the cognizant agency to reopen the approved plan is stated in Attachment C, paragraph F.2, e.g., if there is a violation of a statute or if submitted information was materially incomplete or inaccurate. Inclusion of unallowable or unallocable costs under Circular A-87 will not be grounds for reopening. In such cases, a roll-forward adjustment or refund will be made at the cognizant agency's option.

- 4-2 If a central service activity, either allocated (Section I) or billed (Section II), is omitted when the state/local-wide cost allocation plan (SWCAP/LOCAP) is approved, can the carry forward procedure be used to recover the cost of the omitted activity in a future plan? [Att. C, § C]**

Attachment C, Section C specifically states that costs of central services omitted from the plan will not be reimbursed. However, OMB clarifies in the preamble to the May 17, 1995 *Federal Register* notice of the Circular's issuance that if a service **did not exist** (as opposed to being overlooked) when the plan was prepared, the approved plan can be reopened to include the new activity. In such cases, the plan will be amended to include the nonexistent activity. The definition of "nonexistent" does not include central services that existed when the plan was finally approved, nor those that the state should have known would exist in the future, based on budgets approved by the state legislature.

- 4-3 Does Circular A-87 require primary recipients to prospectively review cost allocation plans and negotiate indirect cost rates with all organizations to which it makes cost reimbursement subawards? OMB does not impose a similar requirement on Federal agencies. [Att. C, ¶ D.3]**

Circular A-87 does not specifically prescribe procedures to be used by primary recipients in accepting claims for indirect costs made by organizations to which they make subawards. The Circular states: "Where a local government only



receives funds as a sub-recipient, the primary recipient will be responsible for negotiating indirect cost rates and/or monitoring the sub-recipient's plan." (Att. C, ¶ D.3.) This would permit a primary recipient to actually engage in prospective review and negotiation. Alternatively, the primary recipient could require subrecipients to develop the necessary documentation concerning indirect charges and retain the documentation for audit and could then review audit reports to determine whether proper cost charging occurred. It would also be acceptable for primary recipients to use a combination of these methods, depending upon the relative size of the subrecipient. As accountability for the Federal funds ultimately rests with the primary recipient, the level of risk and exposure should be the determining factors in what oversight will be required.

**4-4 Attachment C, Section E provides the cognizant agency with flexibility in the types of information and documentation it can require when approving central service cost allocation plans (SWCAPs/LOCAPs). Are there limits on this authority? [Att. C, § E]**

The data and information that a cognizant agency can require is subject to reasonableness. Factors to be considered when assessing documentation needs are: (1) the overall size of the government unit; (2) the timing of previous reviews and the results of such reviews; (3) the appearance of systemic problems; (4) the reoccurrence of problems/issues; (5) the veracity of information provided in the past; and (6) the level of "good faith" exercised in the past by the government or its consultants, if applicable.

**4-5 Attachment C, paragraph E.2 requires that a summary schedule be provided showing the allocation of each service to the specific benefitted agencies. Can the allocations to small or inconsequential agencies be included in a grouping, such as "other"? [Att. C, ¶ E.2]**

Such a practice is permissible where, in fact, the agencies/activities are inconsequential and they receive no Federal awards. However, a narrative description must be provided listing all agencies/activities that have been included in the grouping, so that it can be verified that all operations of the government have been included in the base.

**4-6 Attachment C, paragraph E.3.b. identifies the requirements for the submission of information to the cognizant agency concerning internal service funds (ISFs). What is the definition of an ISF? [Att. C, ¶ E.3.b(1)]**

The definition is provided in generally accepted accounting principles, i.e., a fund used "to account for the financing of goods or services provided by one department or agency to other departments or agencies of a government or to other governments, on a cost-reimbursement basis." (*Codification of Standards of Governmental Accounting*, 1300.104. Governmental Accounting Standards Board.) Internal Service Funds (ISFs) would be separately recognized in the financial statements using the accrual basis of accounting. However, this section of A-87 covers more than ISFs for central service activities of a state or local government. It covers the submission requirements of all central service activities for which the state or local government uses a billing mechanism (formal or memo billing) to assign or allocate costs to other components of the respective government. This requirement applies whether or not the "billed" activity is established in the unit's financial statements as a true ISF under

generally accepted accounting principles.

**4-7 Under a central service cost allocation plan (SWCAP/LOCAP), is the government required to submit documentation for internal service funds (ISFs) with operating budgets under \$5 million? [Att. C, ¶ E.3.b(1)]**

Attachment C, paragraph E.3.b(1) specifies documentation requirements for internal services funds (ISFs) with operating budgets of \$5 million or more. It also states that the requirements may be modified, expanded, or reduced by the cognizant agency on a case-by-case basis. At a minimum, the government or component must submit a schedule for ISFs under \$5 million that reconciles the ISF Retained Earnings. Illustration 4-7 provides a sample schedule format for making such presentations. This schedule provides information that is essential for Federal review and approval of the ISFs and which is not included in the comprehensive annual financial report (CAFR) or other financial statements. In addition, the reconciliation determines an A-87 allowable balance on an on-going basis. Additional documentation may be requested on a case-by-case basis, depending, in part, on the dollar impact on Federal awards and when a detailed review of the ISF was last performed by the cognizant Federal agency.

**4-8 Attachment C, paragraph E.3.b(1) requires the governmental unit to provide a description of the procedures (methodology) used to charge the costs of each service to the user, including how the billing rates are determined. How much detail is required on how billing rates are determined? [Att. C, ¶ E.3.b(1)]**

Like any other aspect of the submission requirements, the governmental unit is required to submit sufficient documentation for the reviewer to make an informed judgement as to the acceptability of the basis used by the unit of government. Such documentation would include: (1) the items of expense making up the billed activity; (2) the specific data used to develop the billing rate(s) and how often they are updated; (3) justification as to why the method used is the most appropriate for the activity; (4) an identification of any users that are not billed, with assurance that their share of services are reflected in the base; (5) how often billings are compared to actual costs and usage; (6) how variances will be adjusted; and (7) any other information the cognizant agency requires to evaluate the reasonableness of the billing system.

**4-9 Attachment C, paragraph E.3.b(2) of the May 4, 1995 revision to Circular A-87 requires that the expenses of the billed function be broken out by object cost categories. In the past, submissions were permitted where a break-out of salaries and wages was made, but a roll-up of all other costs was presented as one amount. Can this practice continue, supported with detailed, on-site accounting records, or must the plans be modified to include the detail? [Att. C, ¶ E.3.b(2)]**

A listing of the items of expenses is required for each central service activity whether it is a billed or unbilled activity. In addition, as noted in the beginning of Attachment C, Section E, the documentation requirements can be reduced by the cognizant agency. For example, reduced documentation might be appropriate for a central service function which has little or no impact on Federal awards. Therefore, the initial plan should address the A-87 documentation requirement, unless the cognizant agency approves otherwise based on the

Federal effort, significance of "roll-up amount," and other factors.

**4-10 Under what circumstances are working capital reserves permitted for internal service funds (ISFs) and how are they to be determined? [Att. C, ¶ G.2]**

Attachment C, paragraph G.2 permits working capital reserves to allow ISFs sufficient cash to sustain operations between billing cycles. While the Circular authorizes reserves of up to 60-day cash needs, their allowability is not automatic. The following factors are to be considered when establishing reserves and determining whether they will be allowable.

- (1) Reserves are only allowable for enterprise funds and bona fide ISFs recognized in the government's comprehensive annual financial report (CAFR). Reserves are not allowable for activities funded through general revenue appropriations.
- (2) For each fund for which a reserve is determined necessary, the number of days of cash needs, up to 60 days, must be fully supported by a cash flow analysis reflecting billing cycles, revenue receipts, and allowable disbursements.
- (3) Semi-annual or annual payments are to be amortized in billing rates.
- (4) Reserves, for purposes of Federal recognition, may only include allowable cash disbursements. Depreciation, principal payments, and capital expenditures are not allowable. However, interest payments are allowable.
- (5) Self-insurance funds, including fringe benefits operating as such, are further subject to the provisions of Circular A-87, Attachment B, paragraph 25.
- (6) Pension funds are subject to Circular A-87, Attachment B, paragraph 11.
- (7) Allowability of reserves covering longer periods can be granted by the cognizant agency in extraordinary circumstances where such needs are fully documented and justified.

**4-11 Earnings on ISF cash balances are to be treated as applicable credits. If a state co-mingles its funds, how is the amount of earnings for a single fund to be determined? [Att. C, G]**

When known, actual earnings should be used. In the circumstances described above, earnings may be imputed by applying the government's, e.g., State Treasurer, Average Rate of Return on the average monthly balance for a given fund.

**4-12 Attachment C, paragraph G.4 establishes four methods for adjusting internal service funds (billed central services) for profits or losses realized from operations. Alternative (b) allows credits to amounts charged to the individual programs. This method would only cover profits. If losses occur, why can't individual programs be debited? [Att. C, ¶ G.4]**

Effectively, alternative (b) is correcting billed costs in the current year, whereas alternative (c) is carrying forward the profit/loss into the next open fiscal period. The failure of the Circular to note how losses are to be treated in alternative (b) is an editing error. For consistency purposes, both alternative (b) and (c) cover profit and loss situations. However, only one method can be used in a given fiscal year.

**4-13 Attachment C, paragraph G.4 allows adjustments to allocated, unbilled central service costs ("Section I costs") as an option for adjusting a particular billed service ("Section II costs") if the amount of the adjustment does not exceed \$500,000. May this adjustment be made in the normal course of plan preparation or is prior Federal approval required? [Att. C, ¶ G.4]**

Prior Federal approval is not required by Circular A-87. It should be noted, however, that the \$500,000 threshold applies to the entire billing function and not to components of that function.

**EXAMPLE:** A data service facility typically has numerous cost centers for which it develops individual billing rates. The allocation method for adjusting over/under billings can only be used if the net, total adjustment for the data facility is less than \$500,000.

**4-14 For adjustments exceeding \$500,000, Attachment C, paragraph G.4 presents three options. What criteria will be used to select the method of recovery? [Att. C, ¶ G.4]**

The primary concern would be the assurance that the Federal programs charged in a given year receive an equitable and appropriate adjustment for the over/under billings. Consideration must also be given to the makeup of the user community in future periods as well as the level of support they will require.

# PART 5

## Attachment D — Public Assistance Cost Allocation Plans

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### 5.1 Highlights of New Section, Attachment D

The new Attachment D deals with Public Assistance Cost Allocation Plans (PACAPs) and incorporates longstanding HHS policies and procedures. The Attachment makes HHS's 45 CFR Part 95, Subpart E applicable to all Federal programs administered by a public assistance agency, e.g. the U.S. Department of Agriculture's (USDA) Food Stamp program.

### 5.2 Applicability of Regulations at 45 CFR Part 95, Subpart E

Federal programs that provide public assistance to individual citizens are often administered at the state level by large, complex, multi-functional agencies. The programs administered by these governmental organizations are predominately financed by the Department of Health and Human Services (HHS). HHS has long required cost allocation plans for those programs and codified rules for development, submission, approval, and use of these plans in 45 CFR Part 95, Subpart E. However, these rules only applied to HHS programs, although there are other Federal agencies whose assistance awards may be handled by the same state units. Accordingly, revised OMB Circular A-87 provides a means for coordinating and assuring consistency among the various Federal agencies. Attachment D of the revised Circular:

- describes the basic policy concerning public assistance cost allocation plans (PACAPs);
- reflects the salient features of 45 CFR Part 95; and
- extends requirements of 45 CFR Part 95 to all Federal agencies whose programs are administered by a state public assistance agency.

A public assistance cost allocation plan must be prepared, documented, and implemented by all state public assistance agencies. The plan and any amendments to it must be submitted to the appropriate field office of HHS' Division of Cost Allocation. HHS, as well as other affected Federal agencies, will review new plans or plan amendments. The other agencies will provide comments to HHS, which will in turn act as the cognizant agency on behalf of the others. HHS conducts any negotiations with the state agency and is responsible for notifying the agency about action taken on the plan or plan amendment.

Due to the nature of state public assistance agency operations, a public assistance cost allocation plan is required in lieu of an indirect cost rate proposal. A large percentage of agency operations consist of common or indirect costs: program-specific, first-tier cost centers are minimal. Typically, a considerable amount of the work performed involves determining and continuing to verify the eligibility of program beneficiaries. The persons who handle these tasks do so for multiple Federal and state programs. For

example, in determining the eligibility of a person for one program, the case worker may concurrently perform tasks related to another program. Or, the determination established for one program simultaneously determines eligibility for additional programs without any additional incremental effort.

The nature of the work performed at state public assistance agencies can result in complex costing issues that are unique to those agencies. However, the concepts and principles contained in Attachment D of the Circular can have applications for other state and local agencies that operate in a Federally funded environment where an indirect cost rate inadequately identifies cost of operations and greater precision is needed. An example might be a state health department which has county and municipal facilities that offer a variety of services that are partially or completely Federally funded. For example, local public health clinics typically operate clinics where they provide general health assessments, medical care, immunizations, health counseling, nutrition guidance, etc. Their funding, for a single, one-day clinic, could come from a variety of sources, including direct Federal grants from several agencies, e.g., well baby clinics (MCH/HHS), nutrition assistance (WIC/USDA), immunizations (PHS/HHS), primary or secondary cost reimbursement funding for health assessments (EPSDT/HCFA/HHS), and provider fees for services provided (Medicaid/HHS). Obviously, the potential for duplicate claims is great. The cost allocation procedures described in 45 CFR Part 95, Subpart E can assist in clarifying the appropriate burden to be borne by each Federal program.

Another example of the importance of these procedures involves the somewhat atypical organizational structures that have arisen in recent years at the state level. Through the formation of cabinet or "umbrella" type structures, public assistance programs may be operated by the same entity type that handles unemployment programs, job training, juvenile detention, and even the state prison system. Some of the programs may include those, such as certain block grants, that have been exempted from mandatory application of Circular A-87. All of these programs and activities must be included in the PACAP to ensure that they receive an equitable share of administrative and other indirect costs. While the level of detail to be included in the cost allocation plan for these other nonpublic assistance programs is less than that required for the public assistance programs, HHS will, in reviewing and approving the plans, be responsive to the expressed needs of those Federal agencies whose programs are included and who need to identify allowable and unallowable program activities and costs for their programs. Where an operating component within the umbrella agency is funded primarily from a single Federal agency, that Federal agency may be designated by the cognizant agency responsible for reviewing and approving that component of the plan.

Under Attachment D of Circular A-87, when a letter of approval or disapproval of a PACAP is transmitted to a state public assistance agency in accordance with 45 CFR Part 95, Subpart E, the letter *will* apply to all Federal agencies and programs. This policy is effective for plans and amendments submitted or prepared for a state's fiscal years beginning on or after September 1, 1995.

### **5.3 Submission and Documentation Requirements**

State public assistance agencies are required to submit a cost allocation plan that describes the procedures used to identify, measure, and allocate all costs to each of the programs they operate. The plan must contain sufficient detailed information for Federal officials to reach an informed judgment about the correctness and fairness of the methods employed by the state. The submission must be sent to the appropriate field office of the Division of Cost Allocation, HHS, and should include the following

features:

- an organizational chart showing the placement of each unit whose costs are charged to the programs operated by the state agency;
- a listing of all Federal and all nonfederal programs performed, administered, or serviced by these organizational units;
- a description of the activities performed by each organizational unit and, when not self-explanatory, an explanation of the benefits provided to Federal programs;
- the procedures used to identify, measure, and allocate all costs to each benefiting program and activity (including those that may be subject to different rates of Federal financial participation);
- the estimated cost impact resulting from proposed changes to a previously approved plan (however, subsequent approval of the cost allocation plan does not constitute approval of the estimated costs for use in calculating claims for Federal financial participation);
- unless the costs are addressed in a state or local-wide cost allocation plan or an umbrella department cost allocation plan, a statement stipulating that wherever costs are claimed for services provided by a governmental agency outside the state agency, they will be supported by a written agreement that includes certain minimum features, including (1) the specific services being purchased, (2) the basis on which billing will be made by the provider agency, and (3) a stipulation that the billing will be based on the actual cost incurred;
- a cost allocation plan for local agencies, if public assistance programs are administered by local governments under a state-supervised system;
- a certification by a duly authorized official of the state that (1) information contained in the plan was prepared in accordance with Circular A-87, (2) the costs have been accorded consistent treatment in accordance with generally accepted accounting principles, (3) an adequate accounting and statistical system exists to support claims that will be made under the plan, and (4) the information provided in support of the cost allocation plan is accurate; and
- other information that may be necessary for HHS to establish the validity of the procedures used to identify, measure, and allocate costs to all programs being operated by the state agency.

(45 CFR § 95.507).

#### **5.4 Amendments**

A state must promptly amend the public assistance cost allocation plan and submit the amended plan to the appropriate field office of the Division of Cost Allocation, HHS, whenever any of the following events occur:

- the procedures shown in the existing plan have become outdated because

of organizational changes, changes in Federal law or regulation, or significant changes in program levels affecting the validity of approved cost allocation procedures;

- a material defect is discovered in the cost allocation plan by the Division of Cost Allocation field office or by the state;
- the state programmatic plan for public assistance programs is amended in a manner that affects the allocation of costs; or
- other changes occur which make the allocation basis or procedures in the plan invalid.

(45 CFR § 95.509).

Even if none of these types of changes has occurred, an annual statement, indicating that the existing plan is not outdated, must be submitted by the state to the HHS Division of Cost Allocation field office.

If an amendment is submitted and approved, its effective date will generally be the first day of the calendar quarter following the date of the event that made the amendment necessary. However, under certain conditions involving inequity, error, or impracticality, the date could be established either earlier or later.

### **5.5 Review and Approval of Plans**

Within sixty (60) days of receipt of a proposed cost allocation plan or amendment, the Director of the HHS Division of Cost Allocation field office will notify the state that the submission is either specifically approved or disapproved, that modifications are needed in order for approval to be granted, or that additional information is needed to evaluate the submission. Also, if a determination cannot be made within the 60 day period, the field office will notify the state. If a plan submission is disapproved, the state will be notified accordingly, along with the reasons for the disapproval. Under 45 CFR Part 16, a state may appeal a disapproval of a plan submission so long as the appeal is postmarked no later than 30 days after receipt of the determination letter. (45 CFR § 16.7(a)).

### **5.6 Claims Under PACAPs**

Any claims developed under approved cost allocation plans must be for allowable costs under OMB Circular A-87. Where unallowable costs have been claimed, they must be refunded to the Federal program that originally accepted them either by a cash refund, an offset against a subsequent claim (if authorized), or credits to the amounts charged to individual awards.

### **5.7 Questions and Answers on Attachment D**

**5-1 In the early 1960s the former Department of Health, Education, and Welfare (HEW) issued a document entitled "Handbook of Public Assistance Administration." Is this issuance still in effect, and if so, which Federal issuance takes precedence when sections of that handbook contradict the cost principles of Circular A-87, e.g., treatment of the cost of land? [Att. D, § A]**

Under an Action Transmittal Notice of August 11, 1975, the former Social and



Rehabilitation Service of (then) HEW advised State agencies that, as published in the *Federal Register* on August 11, 1975, Parts I, II, and VI, and Supplements A, B, and C of the Handbook were revoked. Parts III, IV, and V were still in effect to the extent that they were not superseded by subsequent regulation or policy issuances. OMB Circular A-87 was issued to bring consistency to the manner in which Federal awarding agencies measured and recognized allowable administrative costs. Federal agencies are required by OMB to implement the Circular and abide by those rules unless OMB has granted a specific waiver to the agency for a rule(s) or the Circular is in conflict with a given statute. Therefore, if the Handbook conflicts with any section of A-87, Circular A-87 policy would apply unless the exceptions noted above exist.

- 5-2 45 CFR Part 95.507(b)(6) requires that a statement be submitted describing services provided by a governmental agency outside the state agency other than those provided through the state-wide cost allocation plan (SWCAP) or umbrella department cost allocation plan (CAP) costs. If this other agency is only a subrecipient of Federal monies from the state (or local) agency and the subrecipient proposes a cost allocation procedure, who is responsible for the review and approval of this plan? [Att. D, ¶ D]**

Review and approval of the plan used by the subrecipient governmental agency is the responsibility of the state agency. The Part 95 provision referenced above does not require Federal approval. It has been long-standing policy that the prime grantee is responsible for assuring that subawardees properly spend and account for flow-through Federal funds. Where the subrecipient has an indirect cost agreement or cost allocation plan approved by a Federal cognizant agency, costing and claims to the primary recipient agency should be made in accordance with that agreement (plan). The amounts claimed under these procedures are still subject to audit and to Federal awarding agency review of quarterly claims.

- 5-3 Attachment D, paragraph D.2 states that the effective date of the plan is "the first day of the quarter following the submission of the plan or amendment, unless another date is specifically approved by HHS." 45 CFR 95.515 states "[a]s a general rule, the effective date of a cost allocation amendment shall be the first day of the calendar quarter following the date of the event that required the amendment." The date may be earlier or later based on specific conditions. Is there an inconsistency between the two effective dates as currently stated? [Att. D, ¶ D.2]**

No. The state agency is required to promptly amend its cost allocation plan when one of several conditions occurs. Therefore, these dates should effectively be the same.

- 5-4 Attachment D, paragraph E.3 states "[i]f a dispute arises in negotiation of a plan or from a disallowance involving two or more funding agencies, the dispute shall be resolved in accordance with the appeals procedures set out in 45 CFR Part 75. Disputes involving only one funding agency will be resolved in accordance with the funding agency's appeal process." The wording implies that single funding issue disputes, whether it involves the negotiation of a plan or disallowance, will be resolved through the funding agency appeal process. 45 CFR Part 95, Subpart E requires use of the Part 75 appeal process for plan disapprovals, and splits responsibility for cross-cutting and single agency disallowance actions. Is this inconsistent with the**

**revision to Circular A-87?** [Att. D, ¶ E.3]

No. Disputes involving plan disapprovals are subject to 45 CFR Part 16 governing the Departmental Appeals Board Procedures. (Due to reorganization within HHS, Part 75 has been rescinded.) Single-funding agency disallowance actions are appealed through the applicable funding agency, unless the issue(s) involve cost accounting practices or policies. In such cases, the cognizant agency may determine that the appeal will be handled through its process.

**5-5 Attachment D, paragraph E.1 provides for after-the-fact reviews to assure compliance with approved plans. The circular states that these reviews can be accomplished by the funding agency, single audits, or the cognizant audit agency. Does the A-87 language preclude the cognizant agency responsible for approval of the plan from performing compliance reviews?**  
[Att. D, ¶ E.1]

No. The term "funding agency," in this context, includes the cognizant agency responsible for negotiating the plan approval. Compliance reviews are part of the oversight function in the approval of the cost allocation plan (CAP).

## PART 6

# Attachment E — State and Local Indirect Cost Rate Proposals

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### 6.1 Highlights of New Section, Attachment E

Attachment E has been added for state and local indirect (IDC) rate proposals. This Attachment is also a compendium of conventions, internal HHS policies and procedures, and portions of the former OASC-10. The Attachment provides definitions, submission requirements, how to develop a rate(s), documentation requirements, etc. for IDC rates issued to state and local agencies.

### 6.2 Acceptable Methodologies for Indirect Cost Allocation and Rate Determination

#### 6.2.1 Types of Rates

Circular A-87 defines four possible types of indirect cost rates. However, two of these types, the provisional and the final, are actually two stages of one approach. The types of rates are listed below:

1. A *provisional* rate is a temporary rate, agreed to in advance, based on anticipated future costs. It is subject to retroactive adjustment at a future date after costs are known.
2. A *final* rate is established after the costs are known. It adjusts the provisional rate but is administratively burdensome. Underpayments resulting from application of the provisional rate are subject to availability of funds, while overpayments must be credited or returned.
3. A *fixed* rate is also agreed to in advance, based on an estimate of future costs, but it is not retroactively adjusted. Instead, the difference between estimated and actual costs is carried forward to future years.
4. A *predetermined* rate is agreed to in advance, based on an estimate of future costs, but is not subject to adjustment except under very unique circumstances. It is intended to be permanent and thereby reduce the administrative burden associated with indirect cost recovery. A predetermined rate may not be used for any governmental unit that does not submit its indirect cost rate proposals to a cognizant agency for negotiation, nor may it be used on Federal contracts. The 1995 revision of Circular A-87 encourages long-term use of predetermined rates over a period of two to four years where there is a high degree of assurance that the agreed-upon rate will not exceed one that would result if actual costs were determined.

#### 6.2.2 Direct Cost Bases

The direct cost base is used to distribute indirect costs to individual Federal awards, i.e., an indirect cost rate must be applied to a direct cost base in order to determine the

amount of indirect costs. There are two basic types of direct cost bases: total direct salaries and wages (S&W), or modified total direct costs (MTDC). MTDC exclude "any extraordinary or distorting expenditures," usually capital expenditures, subawards, contracts, assistance payments (e.g., to beneficiaries), and provider payments. The direct cost base selected should result in each award bearing a fair share of indirect costs in reasonable relation to the benefits received from those indirect costs.

### **6.2.3 Simplified Method**

There are two basic methods for calculating indirect cost rates—the simplified method and the multiple rate method. Where each of a recipient agency's major functions benefit from its indirect costs to approximately the same degree, the allocation of indirect costs may be accomplished under the simplified method. The steps involved in calculating a rate under the simplified method are shown below:

#### **Steps Involved in Calculating a Rate Under the Simplified Method**

1. Adjust indirect costs for the period by eliminating any costs directly reimbursed through a Federal award awarded specifically for that purpose. For example, if a construction grant was received, then no depreciation or use allowance should be included in the indirect cost pool. Likewise, remove any administrative salaries included in the pool that were funded as direct in a grant. The pool also must be adjusted for any A-87 unallowables and capital expenditures. Use allowances should be computed and added to the pool along with any CSCAP allocations.
2. Adjust direct costs by eliminating flow-through funds and capital expenditures. Compute and add use allowances.
3. Divide the total allowable indirect costs (net of applicable credits) by an equitable direct cost base, e.g. salaries and wages or modified total direct costs.

Illustration 6-1 illustrates the distribution of indirect costs of a state or local government department, the division/bureaus of the department, and the cost of central services provided to it. Under the simplified method shown in this illustration, indirect costs are identified at the division or bureau level, and are so indicated. This method may be used if the ratio of the indirect costs to direct salaries and wages (or other selected base) of each division or bureau reasonably approximates the ratio of the other divisions or is otherwise not inequitable to the Federal Government. If the indirect/direct ratio varies significantly between divisions or bureaus, the multiple rate method (Illustration 6-3) should be used.

**Illustration 6-1**

**Sample Indirect Cost Rate Proposal - Simplified Method  
Department of Environmental Services  
For the Fiscal Year Ended June 30, XXXX**

					<u>Direct Costs (c)</u>	
	<u>Total</u>	<u>Exclusions</u>	<u>Expenditures Not Allowable</u>	<u>Indirect Costs</u>	<u>Direct Salaries &amp; Wages</u>	<u>Expenditures For All Other Purposes</u>
	<u>(e)</u>	<u>(a)</u>	<u>(b)</u>	<u>(d)</u>		
<i>Division/Bureau</i>						
Air Quality and Noise	\$ 438,338		\$ 36,820	\$ 47,480	\$ 206,320	\$147,718
Community Environmental Control	691,931		22,161	61,210	481,182	127,378
Water Quality Management	2,390,738	\$1,800,000	9,945	52,641	410,771	117,381
Solid Waste Disposal	1,153,057		106,210	96,847	643,782	306,218
Parks and Forests	<u>844,617</u>		<u>115,000</u>	<u>91,119</u>	<u>450,788</u>	<u>187,710</u>
Subtotal	\$5,518,681	\$1,800,000	\$290,136	\$349,297	\$2,192,843	\$886,405
<i>Departmental Indirect Costs</i>						
Office of the Director	\$ 122,610			\$122,610		
Financial Management	155,275			155,275		
Administrative Services	86,930			86,930		
Equipment Use	<u>16,800</u>			<u>16,800</u>		
Running Subtotal	\$5,900,296	\$1,800,000	\$290,136	\$730,912	\$2,192,843	\$886,405
<i>Services Furnished (But Not Billed)</i>						
<i>By Other Government Agencies (f)</i>						
Personnel	\$ 87,060			\$ 87,060		
Accounting	216,220			216,220		
Purchasing	22,211			22,211		
Audit	<u>12,210</u>			<u>12,210</u>		
Total	<u>\$6,237,997</u>	<u>\$1,800,000</u>	<u>\$290,136</u>	<u>\$1,068,613</u>	<u>\$2,192,843</u>	<u>\$886,405</u>

This is a sample. It is not intended to prescribe methods of charging costs.
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## Notes to Illustration 6-1

- (a) Under some Federal programs, funds (called "flow-through funds") are provided to a primary recipient and subsequently passed through to another organization which actually performs the program for which the funds are provided. There is no measurable involvement by the primary recipient in the expenditure of the funds. The primary recipient's involvement is generally limited to monitoring and oversight. This example illustrates such a situation. Because these funds, which are recorded as a cost in the records of the department, do not reflect the expenditure of resources, they are excluded from the computation. However, if the primary recipient does in fact incur significant costs administering the grant, then it should be assessed for its equitable share of indirect costs. This column is normally used by states only and not local governments.
- (b) Expenditures not allowable. This amount represents costs or capital expenditures and costs, whether direct or indirect, which are unallowable in accordance with the cost principles. Although a cost may be unallowable, if it either generated or benefitted from the indirect costs, it should be moved to the base (provided that it is salaries and wages in this example) and allocated its share of indirect costs.
- (c) Under the simplified method, a determination is made as to which activities are direct, illustrated under the heading Direct Costs, and which are indirect, illustrated under the heading Indirect Costs.
- (d) Once the determination of direct/indirect has been made, a ratio should be determined for each division/bureau as shown in the following calculation:

	Indirect	Direct	Salaries
<u>Division/Bureau</u>	<u>Costs</u>	<u>and Wages</u>	<u>Ratio</u>
Air Quality & Noise	\$47,480	\$206,320	23.01%
Community Environmental Control	\$61,210	\$481,182	12.72%
Water Quality Management	\$52,641	\$410,771	12.82%
Solid Waste Disposal	\$96,847	\$643,782	15.04%
Parks & Forests	\$91,119	\$450,788	20.21%

In this illustration, the dollar amounts of indirect costs differ significantly between division or bureau; however, when individually expressed as a percentage of direct salaries and wages, the differences are minor. Therefore, a single overall rate for the department may be computed by adding the departmental indirect costs and the costs incurred by other government agencies and allocating the indirect cost pool over a single base.

- (e) Total departmental costs. This amount should be reconciled to the financial statements or other supporting documentation included in the proposal.
  
- (f) Costs incurred by other government agencies. This amount must agree with the amounts shown on the central service cost allocation plan (see Illustration 4-4). In Illustration 6-1, costs of \$337,701 represent costs of central services allocated to the entire department. Governmentwide services that are billed directly to departments or to programs must also be documented in the cost allocation plan (See Illustration 4-5).

## Illustration 6-2

### Department of Environmental Services Sample Indirect Cost Rate Proposal - Simplified Method For the Fiscal Year Ended June 30, XXXX

<u>Total</u>	<u>Exclusions &amp; Expenditures Not Allowable</u>	<u>Indirect Costs</u>	<u>Direct Salaries &amp; Wages</u>	<u>Other Direct Expenditures</u>
<u>\$6,237,997</u>	<u>\$290,136</u>	<u>\$1,068,613</u> (A)	<u>\$2,192,843</u> (B)	<u>\$886,405</u>

(A) divided by (B) =  $\frac{\$1,068,613}{\$2,192,843}$  = Indirect cost rate of 48.73% of direct salaries and wages, excluding fringe benefits.

#### Notes:

The totals from Illustration 6-1 are brought forward to this illustration. The indirect cost rate is expressed as a percentage resulting from the ratio of the allowable indirect costs (\$1,068,613) to the direct salaries and wages (\$2,192,843).

In this illustration, fringe benefits applicable to direct salaries and wages are treated as direct costs.

This is a sample. It is not intended to prescribe methods of charging costs.



#### **6.2.4 Multiple Allocation Base Method**

Where a recipient agency's indirect costs benefit its major functions in varying degrees, the multiple rate method is more appropriate.

##### **Steps Involved in Calculating Rates Under the Multiple Rate Method**

1. Classify departmental indirect costs into functional cost groupings (cost pools) which benefit divisions of the agency in significantly different proportions.
2. Select appropriate bases for distribution of each classified pool of indirect costs.
3. Distribute each classified pool to the benefitting division.
4. Calculate an indirect cost rate for each division of the agency by relating the total indirect costs allocated to that division to that unit's direct cost base.

Illustration 6-3 shows the distribution of indirect costs on a multiple allocation basis to each division or bureau within a department. This method results in more definitive costing and should be used when operating differences between divisions or bureaus result in material differences in the use of resources and in costs.

The computation recognizes the indirect costs of each division or bureau, department level administration, and the cost of services furnished by other government agencies and approved through the central service cost allocation plan. These costs are allocated to the divisions or bureaus on bases which most fairly reflect the extent to which they benefit from or generate the costs. For example, the costs of purchasing services is allocated on the number of purchase orders issued, while the costs of personnel administration is allocated on the number of employees serviced.

Indirect costs allocated from the department level and from the central service plan are added to the indirect costs incurred by each division or bureau to arrive at total indirect costs for each of the divisions or bureaus. A rate is developed for each division or bureau by relating its indirect costs to its salaries and wages or other selected base.

### Illustration 6-3

## Sample Indirect Cost Rate Proposal - Multiple Rate Method Department of Environmental Services For the Fiscal Year Ended June 30, XXXX

	Allocation Base (a)	Total Indirect Costs (b)	Services Furnished by Other Gov't Agencies				Departmental Costs (d)					Total (f)
			Personnel	Accounting	Purchasing	Audit	Director	Financial Mgmt.	Admin. Services	Equipment		
<i>Services Furnished (But Not Billed) By Other Government Agencies (c)</i>												
Personnel	No. of Employees	\$ 87,060	(\$87,060)									
Accounting	No. of Employees (e)	216,220		(\$216,220)								
Purchasing	No. of Purchase Orders	22,211										
Audit	No. of Audit Hours	<u>12,210</u>										
	Subtotal	\$ <u>337,701</u>										
<i>Departmental Indirect Costs</i>												
Director's Ofc.	Direct Salaries & Wages	\$ 122,610										
Financial Mgmt.	Transactions Processed	155,275										
Admin. Services	Direct Salaries & Wages	86,930										
Equipment Use	Uses of Equipment	<u>16,800</u>										
	Subtotal	\$ <u>381,615</u>										
<i>Division/Bureau</i>												
Air Quality and Noise	\$	47,480	\$ 17,545	\$ 41,495	\$ 3,434	\$ 1,089	\$ 24,522	\$ 23,776	\$ 15,543	\$ 1,000	\$	175,884
Community Environmental Control		61,210	12,920	30,575	3,434	1,089	24,522	29,885	10,659	1,000		175,294
Water Quality Management		52,641	11,997	28,394	2,289	1,089	24,522	37,273	10,659	6,000		174,864
Solid Waste Disposal		96,847	36,935	87,362	11,456	6,777	24,522	46,423	29,488	6,000		345,810
Parks and Forests		<u>91,119</u>	<u>7,663</u>	<u>28,394</u>	<u>1,598</u>	<u>2,166</u>	<u>24,522</u>	<u>17,918</u>	<u>20,551</u>	<u>2,800</u>		<u>196,761</u>
	Subtotal	\$ <u>349,297</u>										
	Totals	<u>\$1,068,613</u>	<u>- 0 -</u>	<u>- 0 -</u>	<u>- 0 -</u>	<u>- 0 -</u>	<u>- 0 -</u>	<u>- 0 -</u>	<u>- 0 -</u>	<u>- 0 -</u>	<u>- 0 -</u>	<u>\$ 1,068,613</u>

This is a sample. It is not intended to prescribe methods of charging costs.

### Notes to Illustration 6-3

- (a) The allocation bases used were selected as reasonable and applicable under the circumstances. Other bases could be just as acceptable if they represented a fair measure of cost generation or cost benefit.
- (b) The costs in this column must be reconciled to official financial statements. In this illustration, it is assumed that all costs incurred are allowable and relevant in accordance with OMB Circular A-87. To the extent that unallowable or excludable costs are included therein, a separate column should be added to the schedule to show the amounts and adjustments made.
- (c) These are carried forward from the central service cost allocation plan shown in Illustration 4-4. The costs of services furnished (but not billed) by other government agencies, which are derived through the central service cost allocation plan, are allocated to each functional division or bureau. This allocation could be made more precise by allocating the costs to each departmental administrative function, e.g., to financial management, administrative services, etc., and to the divisions or bureaus. The indirect costs of each departmental administrative service, plus its allocated amount of central service costs, would then be allocated to the divisions or bureaus. If the result of such allocations would have a material effect on the rates computed, the more precise method should be used. In the example presented, the dollar effect is not sufficiently material to warrant this level of precision. In addition to the listed unbilled services, the department also received services from other organizations for which it is billed at rates approved through the central service cost allocation plan (See Illustration 4-5). Illustration 6-3 assumes that these billed costs are already recorded in the accounting records of the department and included in the column Total Indirect Costs, or are treated as a direct cost.
- (d) Departmental indirect costs are allocated to each division or bureau. As with services furnished by other government agencies, explained in Note (c) above, the allocation of certain departmental indirect costs, such as equipment use charges, could have been allocated to other departmental administrative functions, if the results of such allocation would have had a material effect on the rates to be computed. In the example presented, the dollar effect is not sufficiently material to warrant the additional allocations.
- (e) Accounting services rendered by other agencies are allocated to the divisions or bureaus on the basis of number of employees. In Illustration 6-3, the accounting services provided by the central service agency were

predominantly payroll services.

- (f) The total indirect expenses developed for each division or bureau is carried forward to Illustration 6-4, where the relationship between the indirect expenses and direct salaries and wages of each division or bureau is used to develop indirect cost rates.

## Illustration 6-4

### Sample Indirect Cost Rate Proposal - Multiple Rate Method Department of Environmental Services For the Fiscal Year Ended June 30, XXXX

<u>Divisions/Bureaus</u>	<u>Indirect Costs</u> (a)	<u>Direct Salaries and Wages</u> (b)	<u>Indirect Cost Rates</u> (c)
Air Quality and Noise	\$ 169,560	\$ 206,320	82.18%
Community Environmental Control	169,200	481,182	35.16%
Water Quality Management	168,666	410,771	41.06%
Solid Waste Disposal	336,612	643,782	52.29%
Parks and Forests	<u>190,904</u>	<u>450,788</u>	<u>42.35%</u>
<b>Total</b>	<b><u>\$1,068,613</u></b>	<b><u>\$2,192,843</u></b>	

**Notes:**

- (a) The amounts in this column are from Illustration 6-3.
- (b) The amounts in this column are derived from, and must be reconciled to, the books and records of the department. Salaries and wages is the preferred base. However, other bases may be used where it results in a more equitable allocation of costs. Generally, the same base should be used for all divisions; however, if approved by the cognizant Federal agency, different bases may be used for one or more of the divisions.
- (c) The indirect cost rate for each division/bureau is computed by dividing the indirect costs for each division/bureau by the direct salaries and wages of that division/bureau.

$$\frac{\text{division/bureau indirect costs}}{\text{division/bureau direct S\&W}} = \text{indirect cost rates for division/bureau}$$

This is a sample. It is not intended to prescribe methods of charging costs.

### **6.3 Special Rates**

Circular A-87 notes that there may be instances where a single indirect rate for all activities of a recipient department or agency may not be appropriate. Factors such as different physical locations for work, level of administrative support needed, organizational arrangements, and subaward practices, or a combination of these factors, may create the need for separate rates. It is not uncommon for these types of situations to result in a headquarters rate and multiple off-site rates.

In addition, some Federal programs, such as those funded by the Department of Education, place limitations on allowable indirect costs. In those instances, restricted rates are issued.

### **6.4 Submission and Documentation of Proposals**

#### **6.4.1 Documenting Indirect Cost Proposals**

A cognizant agency may require additional data, depending on the circumstances, but each indirect cost proposal must include, at a minimum:

1. The rates proposed, including subsidiary work sheets and other relevant data, cross-referenced and reconciled to the financial data.
2. For allocated central service costs, the summary table included in the approved central service cost allocation plan, unless otherwise available to the funding agency. The summary schedule from the approved central service cost allocation plan is frequently needed because the Federal agency that is cognizant for a departmental indirect cost rate proposal may be different from the one that is cognizant for the central service plan for the overall governmental unit.
3. A copy of the financial data upon which the rate is based.
4. The approximate amount of direct base costs incurred under Federal awards, broken out between salaries and wages and other direct costs. The cognizant agency will use the breakdown between salaries and wages and other direct costs within the direct base costs to determine whether to establish the resulting indirect cost rate on the basis of salaries and wages or modified total direct costs.
5. A chart showing the organizational structure of the agency during the period for which the proposal applies, along with a functional statement(s) noting the duties and/or responsibilities of all units that comprise the agency. The organizational chart that is submitted with

the indirect cost rate proposal should be accompanied by a narrative statement. This statement should provide sufficient detail about the functions that are performed by component units to permit the proposal reviewer (cost negotiator) from the cognizant agency to differentiate levels of benefit provided and received within the organization.

#### **6.4.2 Required Certifications**

Indirect cost rates, whether submitted to a Federal cognizant agency or maintained on file by the governmental unit, must be certified by the governmental unit using the Certificate of Indirect Costs as set forth in Attachment E. The certificate must be signed on behalf of the governmental unit by an individual at a level no lower than chief financial officer of the governmental unit that submits the proposal or component covered by the proposal. (See also 2.9, Government Certification.)

#### **6.5 Review, Negotiation, and Approval of Rates**

OMB Circular A-87 places considerable discretion with the cognizant Federal agency assigned to particular recipients. It permits the cognizant agency to determine, within reasonable bounds, the level of detail that is appropriate to support a cost allocation plan and/or an indirect cost rate proposal. This discretion carries over to the review and approval process as well.

##### **6.5.1 The Review Process**

In general, the cognizant agency will follow certain basic steps for most submissions. Note: there is no hard and fast rule about the approach or tools used. Typical steps in the review process are shown below:

### **Steps in the Review Process**

1. Review the submission for materiality, completeness, and reliability of supporting data, including audited financial statements.
2. Acknowledge receipt and request any needed additional information.
3. Review prior negotiation and audit experience; assess prior agreements and applicable conditions.
4. Assess the submission's general reliability and the governmental unit's financial condition.
5. Determine the extent to which coordination with other awarding agencies may be necessary.
6. Review the proposal for accuracy and determine whether it includes all activities and costs of the governmental entity.
7. Determine whether unallowable costs have been excluded and whether allocation methods and billing mechanisms are appropriate and properly designed.
8. Assess what the appropriate rate base (salaries and wages, modified total direct cost, etc.) should be for the resulting indirect cost rate and the extent to which any rate established should be subsequently adjusted.

#### **6.5.2 Indirect Cost Rate Negotiations**

Negotiations about submissions may be limited or extensive, based largely on the results of the review steps described above. In the case where, for any number of reasons, a rate cannot be negotiated, the Circular does permit unilateral action by a cognizant agency to establish a rate.

#### **6.5.3 Features of a Typical Rate Agreement**

Appendix 3 is an example of a contemporary rate agreement containing the salient features that are likely to appear in those issued by most cognizant agencies. Note: there is no standard governmentwide Federal form employed for the purpose of rate determination.

### **6.6 Applying an Approved Rate to Grants and Contracts**

#### **6.6.1 Establishing the Amount of Approved Indirect Costs in the Award Budget**

Because Circular A-87 establishes a policy that Federal programs bear their fair share of costs recognized under the Circular, Federal awarding agencies are expected to recognize and use indirect cost rates approved by the cognizant agency for a particular recipient. This recognition and use usually



occurs at the time that an award is made. Awarding agency officials review direct cost proposals and applications to determine that anticipated costs included are necessary, reasonable, and allocable. Any proposed indirect costs are assessed according to whether or not an agreement exists with a cognizant agency. If one does, the awarding agency officials determine whether it will be fully recognized and to which object class categories of expenditure it will be properly applied. (Some Federal programs impose regulatory limits on the indirect percentage that will be allowed, e.g., HHS training grants that limit reimbursement to 8% of MTDC.)

If no agreement exists, awarding agencies should encourage recipients to obtain one. In the interim, agencies may only award funds for direct and allocated costs. The awarding agency should conduct a review of these costs to determine the propriety of any allocations. Agencies may not establish indirect cost rates unless they are the cognizant agency for the recipient.

### **6.6.2 Applying the Rate to the Direct Cost Base and Calculating Claims**

Once the indirect cost rate is recognized within an award document, the governmental unit is permitted to apply that rate to the applicable base of the allowable direct costs incurred during award performance. Periodically the governmental unit is expected to submit a Financial Status Report (usually either Standard Form 269 or 269A) which summarizes total expenditures incurred under the award. It may claim indirect costs by multiplying its indirect cost rate by the direct cost elements to which the rate may be applied under the terms of the award. Thus, its total cost recovery for the applicable period is comprised of the allowable direct costs incurred plus the allowable, allocable indirect costs.

### **6.6.3 Effect of Rate Changes from One Fiscal Year to Another**

Occasionally, a governmental unit will receive an award which it performs over a period that extends beyond the applicability of a single, approved indirect cost rate. This is likely when the award period does not correspond to the fiscal year of the governmental unit. In such a case, the recipient is expected to apply its rate(s) to expenditures incurred during the applicable fiscal year and to maintain consistent accounting treatment according to its normal procedures of expenditure recognition.

## **6.7 Record Retention**

The Common Rule issued pursuant to OMB Circular A-102 covers most policies associated with records to be retained and/or disclosed by a governmental unit receiving Federal assistance funds. Section \_\_.42 of that rule requires that all financial and programmatic records, supporting documents, statistical records, and other records of recipients and

subrecipients be retained. Section \_\_.36 (i)(10) of the rule covers the record retention requirement for contractors under grants and their subcontractors.

Generally, records must be retained for three years from the submission date of the final financial report for that funding period. However, if any litigation, claim, negotiation, audit, or other action involving the records has been initiated before the three-year retention period has expired, the records must be retained until the action is completed and all issues which arise from it have been resolved, or until the end of the regular three-year period, whichever is later. (A-102 Common Rule, §\_\_.42(b)(2)).

Section \_\_.42(c)(4) of the Common Rule states that records associated with indirect cost rate proposals and cost allocation plans are included within the scope of the broader record retention requirement. Under that provision, "indirect cost rate computations or proposals, cost allocation plans, and any similar accounting computations of the rate at which a particular group of costs is chargeable (such as computer usage chargeback rates or composite fringe benefit rates)" are covered.

## **6.8 Audit**

Audit of Federal awards is an aid to determining whether financial information is accurate and whether an award recipient has complied with terms and conditions that could have an effect on claims for costs incurred under the award. Under the Inspector General Act of 1978, as amended, the Inspector General of a Federal agency may audit or investigate any program, function, or activity administered by that agency. This potential for review extends to those organizations (including state, local, and Indian tribal governments) that are performing under awards made by the Federal agency. However, as a way to assure the best use of audit resources, the Act requires the Inspectors General to determine the extent to which they can rely on audit work performed by nonfederal auditors. This policy, combined with the fact that the Single Audit Act of 1984, as amended, requires recipients to arrange to have independent audits performed on Federal financial assistance awards that they receive, means that these nonfederal examinations are the principal means by which a governmental unit's compliance with Circular A-87 is determined. OMB is responsible for issuing implementing policies, procedures, and guidelines under the Act.

Applicable OMB guidance for auditors performing audits under the Single Audit Act identifies general and specific requirements against which the auditor is expected to test governmental unit compliance. Several of these requirements relate to policies contained in Circular A-87. Included within the general requirements are:

- allowable costs/cost principles;

- Federal financial reports; and
- administrative requirements.

Included in the specific requirements section of each listed Federal program are use and use restrictions and limitations, including matching and cost sharing, maintenance of effort, and earmarking requirements.

## **6.9 Disputes and Appeals**

If a dispute arises concerning the application of provisions of Circular A-87, the method of resolving the issues raised and the party responsible for adjudicating them depend on the nature of the dispute. For example, if a dispute arises concerning the submission, negotiation, or establishment of a cost allocation plan or indirect cost rate, the procedures of the cognizant agency govern. On the other hand, if a dispute arises about questioned or disallowed costs associated with a particular Federal award, the procedures of the awarding agency govern.

Costs incurred by a governmental unit may be questioned during conduct of an audit or through some other form of monitoring or awarding agency oversight. They may be questioned because of an alleged violation of applicable policy, because they are not supported by adequate documentation at the time of the audit, or because they are deemed to be unreasonable or unnecessary by the responsible auditor or other party examining them. The determination as to whether costs will be disallowed is made by an awarding agency official authorized to issue decisions on behalf of the agency. Depending upon awarding agency procedures, there may be several layers of review within the agency before such a decision is considered final.

Each Federal agency has its own regulations and policies governing administrative appeals of agency determinations, and many agencies either do not allow appeals, or limit them to very specific areas. The costs of prosecuting these claims may not be allowable under agency interpretations of the A-87 prohibition on pursuing claims against the Federal Government.

## **6.10 Questions and Answers on Attachment E**

**6-1 The definition of an "Indirect Cost Rate Proposal" in Attachment E, paragraph B.1 is "the documentation prepared by a government unit...to substantiate its request for the establishment of an indirect cost rate." Based on the definition of "Government Unit" in Attachment A, paragraph B.13, can a state submit a state-wide indirect cost rate proposal in lieu of a state-wide cost allocation plan (SWCAP)? [Att. E, ¶ B.1]**

No. A state, if it wishes to identify and claim all administrative and support costs provided to its components (operating agencies) which receive Federal awards, must prepare and submit a state-wide central service plan (SWCAP) in accordance with Attachment C of A-87. That Attachment, at paragraph D.1, stipulates that "[e]ach State will submit a plan...." The use of the term "governmental unit" in the above referenced Attachment E is viewed as an editing error where "government component" was intended. The only government units that have been permitted to develop indirect cost rates in lieu of cost allocation plans for centralized government support activities are local units of government. This is permitted under Attachment C, paragraph D.3.

**6-2 A review of Attachment E, paragraph D.1.b raises several questions:**

- (a) When reference is made to "governmental unit," is it actually referring to a "government component" for which an indirect cost (IDC) rate is required?**
- (b) It notes that OMB will publish lists of governmental units and their Federal cognizant agencies. Governmental units not listed on OMB's published lists of governmental units and their cognizant agencies must prepare an IDC rate proposal, and keep it on record unless the cognizant Federal agency requires that it be submitted for review and negotiation. In the past, a state component was required to negotiate an IDC rate if it wanted to recover IDCs. Has this policy changed?**
- (c) Based on the comments in (b) above, is a local government that is assigned a cognizant Federal agency required to submit its IDC proposal for review and negotiation? [Att. E, ¶ D.1.b]**

The responses to each of the above are as follows:

- (a) This is an editing error and "component" was intended.
- (b) There has been no change. If a state component wishes to recover its IDC, it must develop, submit, and negotiate an IDC rate or cost allocation plan with the cognizant Federal agency.

- (c) Appendix 2 identifies "major" local governments that have been assigned a cognizant Federal agency. At the present time local governments are not required to submit proposals for approval unless the cognizant Federal agency requires submission.

**6-3 Attachment E, paragraph F.3 discusses IDC CAPs for a governmental unit not by the use of a rate but through a narrative plan similar to public assistance plans. By definition a "governmental unit" is the entire state or local government, not a component thereof. Is this the intent of this section? [Att. E, ¶ F.3]**

No. This was an editorial error. In some cases, because of the nature of its operations, a component or agency may find it necessary to develop a cost allocation plan rather than an indirect cost rate. See Q&A 2-18, Part 2 of this guide, for the criteria to be used when determining when a cost allocation plan should be used in lieu of an indirect cost rate.

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# REFERENCE

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OMB Circular A-87 references many documents. In addition, various bodies have issued documents which should be used in conjunction with Circular A-87 to ensure compliance with standards of accountability in Federal funds management. Pertinent documents are listed below, along with their issue date<sup>1</sup> and source.

<b>This document:</b>	<b>as issued:</b>	<b>may be obtained from:</b>
OMB Circular A-87, <i>Cost Principles for State, Local and Indian Tribal Governments</i>	May 17, 1995	Executive Office of the President (EOP) Publications Office, 202-395-7332 or via the Internet, <a href="http://www.whitehouse.gov/WH/EOP/omb">http://www.whitehouse.gov/WH/EOP/omb</a>  <b>OR</b> the <i>Federal Register</i> <sup>2</sup> at 60 FR 26484
OMB Circular A-102, <i>Grants and Cooperative Agreements with State and Local Governments</i> , and the accompanying Common Rule, <i>Uniform Administrative Requirements for Grants and Cooperative Agreement to State and Local Governments</i>	October 14, 1994 (Circular); March 11, 1988 (Common Rule), as revised April 19, 1995	Executive Office of the President (EOP) Publications Office, 202-395-7332 or via the Internet, <a href="http://www.whitehouse.gov/WH/EOP/omb">http://www.whitehouse.gov/WH/EOP/omb</a>  <b>OR</b> the <i>Federal Register</i> , at 59 FR 52224, 53 FR 8087, 60 FR 19638
OMB Circular A-110, <i>Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations</i> , and the attached Common Rule	November 29, 1993	Executive Office of the President (EOP) Publications Office, 202-395-7332 or via the Internet, <a href="http://www.whitehouse.gov/WH/EOP/omb">http://www.whitehouse.gov/WH/EOP/omb</a>  <b>OR</b> the <i>Federal Register</i> , at 58 FR 62992
The Federal Acquisition Streamlining Act of 1994 (FASA) (PL 103-355)	October 13, 1994	<i>Statutes at large</i> <sup>3</sup>

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<sup>1</sup> All issue dates listed in the Reference section of this guide are issue dates as of publication, 4/8/97.

<sup>2</sup> Back issues of the *Federal Register* are generally available in paper or on microfiche at law libraries and larger public libraries. The 1995 and later issues (volumes 60 and up) are available via GPO Access on the Internet, <http://www.access.gpo.gov>.

<sup>3</sup> Available at law libraries and some larger public libraries. Statutes are filed by public law number.

<b>This document:</b>	<b>as issued:</b>	<b>may be obtained from:</b>
OMB Circular A-128, <i>Audits of State and Local Governments</i> <sup>4</sup>	April 12, 1985	Executive Office of the President (EOP) Publications Office, 202-395-7332, also via fax-on-demand, 202-395-9068 <sup>5</sup> , or via the Internet, <a href="http://www.whitehouse.gov/WH/EOP/omb">http://www.whitehouse.gov/WH/EOP/omb</a>
OMB Circular A-133, <i>Audits of Institutions of Higher Education and Other Non-Profit Institutions</i>	April 30, 1996	Executive Office of the President (EOP) Publications Office, 202-395-7332, also via fax-on-demand, 202-395-9068, or via the Internet, <a href="http://www.whitehouse.gov/WH/EOP/omb">http://www.whitehouse.gov/WH/EOP/omb</a>  <b>OR</b> the <i>Federal Register</i> , at 61 FR 19134, via the Internet, <a href="http://www.access.gpo.gov">http://www.access.gpo.gov</a>
Compliance Supplement for Single Audits of State and Local Governments	September 1990	US Government Printing Office, Superintendent of Documents, Mail Stop: SSOP, Washington, DC 20402-9328, 202-512-1800
Questions and Answers on the Single Audit Process of OMB Circular A-128, "Single Audits of State and Local Governments"	November 13, 1987	The <i>Federal Register</i> , at 52 FR 43712
Common Rule on New Restrictions on Lobbying	February 6, 1990	The <i>Federal Register</i> , at 55 FR 6736
Lobbying Disclosure Act of 1995 (PL 104-65)	December 1995	<i>Statutes at Large</i>  <b>OR</b> via the Internet through GPO Access, <a href="http://www.access.gpo.gov">http://www.access.gpo.gov</a>
OMB Circular A-21, <i>Cost Principles for Educational Institutions</i>	May 8, 1996	Executive Office of the President (EOP) Publications Office, 202-395-7332, or via the Internet, <a href="http://www.whitehouse.gov/WH/EOP/omb">http://www.whitehouse.gov/WH/EOP/omb</a>  <b>OR</b> the <i>Federal Register</i> , at 61 FR 20880, via the Internet, <a href="http://www.access.gpo.gov">http://www.access.gpo.gov</a>
OMB Circular A-122, <i>Cost Principles for Nonprofit Organizations</i>	July 8, 1980, and revised April 27, 1984, May 19, 1987, and October 6, 1995	Executive Office of the President (EOP) Publications Office, 202-395-7332  <b>OR</b> the <i>Federal Register</i> , at 45 FR 46022, 49 FR 18260, 52 FR 19788, 60 FR 52516

<sup>4</sup> This Circular is scheduled to be rescinded; state and local government audits will be covered by a revised OMB Circular A-133.

<sup>5</sup> Only circulars of less than 50 pages are available from OMB's fax-on-demand service.



<b>This document:</b>	<b>as issued:</b>	<b>may be obtained from:</b>
45 CFR Part 95, General Administration – Grant Programs (Public Assistance and Medical Assistance)	October 1, 1996	US Government Printing Office, Superintendent of Documents, Mail Stop: SSOP, Washington, DC 20402-9328, 202-512-1800

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# **APPENDIX 1**

## **OMB CIRCULAR A-87**

### **Cost Principles for State, Local, and Indian Tribal Governments**



# **APPENDIX 2**

## **Cognizant Agency Assignments**



# **APPENDIX 3**

## **Sample Indirect Cost Rate Agreement**





# STATE AND LOCAL RATE AGREEMENT

DATE: July 3, 1996

DEPARTMENT/AGENCY:  
State of X Family & Social  
Services Administration

FILING REF.: The preceding  
Agreement was dated  
May 10, 1994

The rates approved in this agreement are for use on grants, contracts and other agreements with the Federal Government, subject to the conditions in Section III.

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## SECTION I: INDIRECT COST RATES\*

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RATE TYPES: FIXED FINAL PROV. (PROVISIONAL) PRED.(PREDETERMINED)

<u>TYPE</u>	<u>EFFECTIVE PERIOD</u>		<u>RATE(%)</u>	<u>LOCATIONS</u>	<u>APPLICABLE TO</u>
	<u>FROM</u>	<u>TO</u>			
FINAL	07/01/93	06/30/94	14.4	* All	Division of DARS
PROV.	07/01/94	UNTIL AMENDED	14.4	* All	Division of DARS
FINAL	07/01/93	06/30/94	4.4	** All	Div of Mental Health
PROV.	07/01/94	UNTIL AMENDED	4.4	** All	Div of Mental Health

**\*\*BASE:**

Total direct costs of the Division of Mental Health, exclusive of items of equipment, alterations and renovations, State Hospital expenses, and subawards and flow-through funds.

**\*BASE:**

Direct salaries and wages, including all fringe benefits for the Division of Disabilities, Aging, and Rehabilitative Services (DARS), exclusive of the Developmental Disabilities Centers.

NOTE: The State claims use allowance on capital expenditures over \$1,000.

DEPARTMENT/AGENCY:  
State of X Family & Social Services Administration

AGREEMENT DATE: July 3, 1996

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**SECTION II: SPECIAL REMARKS**

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TREATMENT OF FRINGE BENEFITS:

Fringe benefits are specifically identified to each employee and are charged individually as direct costs. The directly claimed fringe benefits are listed in the Special Remarks Section of this Agreement.

TREATMENT OF PAID ABSENCES:

Vacation, holiday, sick leave pay, and other paid absences are included in salaries and wages and are claimed on grants, contracts, and other agreements as part of the normal cost for salaries and wages. Separate claims for the costs of these paid absences are not made.

FRINGE BENEFITS:

FICA

Retirement

Group Insurance

Worker's Compensation

Unemployment Insurance

ORGANIZATION:  
State of X Family & Social Services Administration

AGREEMENT DATE: July 3, 1996

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SECTION III: GENERAL

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A. LIMITATIONS:

The rates in this Agreement are subject to any statutory or administrative limitations and apply to a given grant, contract, or other agreement only to the extent that funds are available. Acceptance of the rates is subject to the following conditions: (1) Only costs incurred by the organization were included in its indirect cost pool as finally accepted: such costs are legal obligations of the organization and are allowable under the governing cost principles; (2) The same costs that have been treated as indirect costs are not claimed as direct costs; (3) Similar types of costs have been accorded consistent accounting treatment; and (4) The information provided by the organization which was used to establish the rates is not later found to be materially incomplete or inaccurate by the Federal Government. In such situations the rate(s) would be subject to renegotiation at the discretion of the Federal Government.

B. ACCOUNTING CHANGES:

This Agreement is based on the accounting system purported by the organization to be in effect during the Agreement period. Changes to the method of accounting for costs which affect the amount of reimbursement resulting from the use of this Agreement require prior approval of the authorized representative of the cognizant agency. Such changes include, but are not limited to, changes in the charging of a particular type of cost from indirect to direct. Failure to obtain approval may result in cost disallowances.

C. FIXED RATES:

If a fixed rate is in this Agreement, it is based on an estimate of the costs for the period covered by the rate. When the actual costs for this period are determined, an adjustment will be made to a rate of a future year(s) to compensate for the difference between the costs used to establish the fixed rate and actual costs.

D. USE BY OTHER FEDERAL AGENCIES:

The rates in this Agreement were approved in accordance with the authority in Office of Management and Budget Circular A-87, and should be applied to grants, contracts, and other agreements covered by this Circular, subject to any limitations in A above. The organization may provide copies of the Agreement to other Federal Agencies to give them early notification of the Agreement.

E. OTHER:

If any Federal contract, grant, or other agreement is reimbursing indirect costs by a means other than the approved rate(s) in this Agreement, the organization should (1) credit such costs to the affected programs, and (2) apply the approved rate(s) to the appropriate base to identify the proper amount of indirect costs allocable to these programs.

BY THE DEPARTMENT/AGENCY:

State of X Family & Social Services Administration  
(DEPARTMENT/AGENCY)

\_\_\_\_\_  
(SIGNATURE)

\_\_\_\_\_  
(NAME)

\_\_\_\_\_  
(TITLE)

\_\_\_\_\_  
(DATE)

BY THE COGNIZANT AGENCY  
ON BEHALF OF THE FEDERAL GOVERNMENT:

DEPARTMENT OF HEALTH AND HUMAN SERVICES  
(AGENCY)

\_\_\_\_\_  
(SIGNATURE)

\_\_\_\_\_  
(NAME)

DIRECTOR, DIVISION OF COST ALLOCATION  
(TITLE)

July 3, 1996  
(DATE) 5629

HHS REPRESENTATIVE: \_\_\_\_\_

Telephone: \_\_\_\_\_

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