

*Additional Information:*

United States Department of Agriculture  
Uniform Federal Assistance Regulations,  
7 CFR Parts 3016, 3019, and 3052.  
[www.gpo.gov/nara/cfr/index.html](http://www.gpo.gov/nara/cfr/index.html)

United States Department of Agriculture,  
Child and Adult Care Food Program  
Regulation, 7 CFR Part 226.  
[www.usda.gov/cnd](http://www.usda.gov/cnd)

United States Department of Agriculture,  
Food and Nutrition Service, Instruction  
796-2, Rev. 3, Financial Management -  
Child and Adult Care Food Program.

Office of Management and Budget  
Circulars: A-87, August 29, 1997; A-102,  
March 11, 1988; A-110, November 29,  
1993; A-122, June 1, 1998; and A-133,  
June 24, 1997.  
[www.whitehouse.gov](http://www.whitehouse.gov)

United States General Services  
Administration, Federal Acquisition  
Regulations, 48 CFR Part 31.  
[www.gsa.gov](http://www.gsa.gov)

Contact State administering agencies or  
United States Department of Agriculture,  
Food and Nutrition Service Regional  
Offices for a copy of FNS Instruction,  
796-2, Rev. 3, Financial Management -  
Child and Adult Care Food Program.



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Director, Office of Civil Rights, Room 326-W, Whitten  
Building, 1400 Independence Avenue, S.W.,  
Washington, DC 20250-9410  
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**CHILD and  
ADULT CARE  
FOOD PROGRAM**

**FNS INSTRUCTION  
796-2, Rev. 3**

**# 2  
ALLOWABLE COSTS**

*This is the second in a series of brochures on  
FNS Instruction 796-2, Revision 3.*

Allowable costs are bona fide obligations of the institution for the necessary and reasonable expenses that result from performing program functions.

### **What is a bona fide obligation?**

A bona fide obligation occurs when the institution has a legal obligation to pay for goods or services.

### **What is the difference between necessary and reasonable?**

The nature of the activity is used to determine if the cost is necessary, while the amount of the cost to perform that activity is used to decide if the cost is reasonable.

### **How do I decide if a cost is necessary?**

A cost is necessary when the activity or function:

- Is generally recognized as ordinary;
- Required for the institution to operate the program; and
- Must be accomplished to fulfill regulatory requirements for proper and efficient operation of the program.

### **How do I decide if the amount of a necessary cost is reasonable?**

The decision that a cost is reasonable is a judgment made using the prudent person standard. Consideration is given to:

- The institution's needs;
- The institution's financial condition, i.e., can the institution afford to incur the cost; and
- The conditions of the market place.

### **What does "using the prudent person standard" mean?**

Given the same circumstances, a sensible person, exercising due care, would spend the same amount of money.

### **Is the prudent person standard the only factor to use when determining if a cost is reasonable?**

No. These additional factors need to be considered:

- The constraints imposed by generally accepted sound business practices;
- Arms-length bargaining;
- Significant deviation from established practices;
- Compliance with Federal and state laws and regulations; and
- The institution acted responsibly.

### **Are there additional factors for allowable costs beyond necessary and reasonable?**

Yes. An allowable cost is:

- Authorized or at least not prohibited by applicable laws, regulations and 796-2, Rev. 3 and conforms to any limitations or restrictions imposed by these documents;
- A cost of the current period;
- Determined using generally accepted accounting principles;
- Net of all applicable credits;
- Properly allocated; and
- Adequately documented.

### **What are program functions?**

Program functions result from administrative and operating activities.

Administrative functions occur in planning, organizing and managing the nonprofit food service.

Operating functions result from the preparation and service of meals to participants.

***NOTE: Additional requirements may apply. Consult 796-2, Rev. 3 and the appropriate administering agency for more information.***