

# Attachment 1 OMB Circular A-87

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

***Instructor:***  
***Stephen  
Garfinkel***

***Presented by:***  
***Office of Departmental  
Grants Management and  
Oversight***  
***December 19 and 20, 2002***

# Cost Principle Applicability

- State, Local and Indian Tribal governments - A-87
- Educational Institutions - A-21
- Nonprofit Organizations - A-122
- Hospitals - Cost principles used by the Federal awarding agency
- Commercial Organizations - Federal Acquisition Regulations

# History of A-87

- 🐼 **1968 Issued by OMB**
- 🐼 **1974 Reissued as FMC 74-4**
- 🐼 **1981 Reissued as OMB A-87**
- 🐼 **1987 Interagency taskforce began review**
- 🐼 **1988 First proposed revisions published**
- 🐼 **1993 Second proposed revisions published**
- 🐼 **1995 OMB issued significantly revised Circular A-87**
- 🐼 **1997 OMB issued slightly revised Circular A-87**

# A-87 Purpose

- To establish principles and standards for determining costs under Federal awards

# **Structure of OMB Circular A-87 Includes Five Attachments**

- A. General Principles for Determining Allowable Costs
- B. Selected Items of Costs
- C. State/local Wide Central Service Plans
- D. Public Assistance Cost Allocation Plans
- E. State and Local Indirect Cost Proposals

# **OMB CIRCULAR A-87**

## **Attachment A**

### General Principles for Determining Allowable Costs

# OMB Circular A-87, Attachment A

## Purpose and Scope

### 1. Objectives

- Allowable cost determination
- Federal awards bear their fair share

### 2. Policy Guides (for governmental units)

- Efficient and effective administration
- Administration consistent with award
- Organization form and management technique is the responsibility of the organization
- (continued)

# OMB Circular A-87 Attachment A

## Purpose and Scope (continued)

### 3. Applications

- Applied by all Federal agencies in determining cost incurred by Governmental units under Federal award (including sub awards).



# OMB Circular A-87, Attachment A

## Definitions

1. “Approval” or authorization of the awarding or cognizant agency means documentation evidencing consent prior to incurring a specific cost.
2. “Award” means grants, cost reimbursement contracts and other agreements between a State, local and Indian tribal government and the Federal Government.
3. “Awarding agency” means (a) with respect to a grant, cooperative agreement, or cost reimbursement contract, the Federal agency, and (b) with respect to a sub-award, the party that awarded the sub-award.  
(continued)

# OMB Circular A-87, Attachment A

## Definitions (continued)

4. "Central service cost allocation plan" means the documentation identifying, accumulating, and allocating or developing billing rates based on the allowable costs of services provided by a governmental unit on a centralized basis to its departments and agencies. The costs of these services may be allocated or billed to users.
  5. "Claim" means a written demand or written assertion by the governmental unit or grantor seeking, as a matter of right, the payment of money in a sum certain, the adjustment or interpretation of award terms, or other relief arising under or relating to the award. A voucher, invoice or other routine
- (continued)

## **OMB Circular A-87, Attachment A Definitions (continued)**

request for payment that is not a dispute when submitted is not a claim. Appeals, such as those filed by a governmental unit in response to questioned audit costs, are not considered claims until a final management decision is made by the Federal awarding agency.

6. "Cognizant agency" means the Federal agency responsible for reviewing, negotiating, and approving cost allocation plans or indirect cost proposals developed under this Circular on behalf of all Federal agencies. OMB publishes a listing of cognizant agencies. (continued)

## **OMB Circular A-87, Attachment A Definitions (continued)**

7. "Common Rule" means the "Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments; Final Rule" originally issued at 53 FR 8034-8103 (March 11, 1988). Other common rules will be referred to by their specific titles.
8. "Contract" means a mutually binding legal relationship obligating the seller to furnish the supplies or services (including construction) and the buyer to pay for them. It includes all types of commitments that obligate the government to an expenditure of appropriated funds and that, except as otherwise authorized, are in writing. In

(continued)

# OMB Circular A-87, Attachment A Definitions (continued)

addition to bilateral instruments, contracts include (but are not limited to): awards and notices of awards; job orders or task orders issued under basic ordering agreements; letter contracts; orders, such as purchase orders, under which the contract becomes effective by written acceptance or performance; and, bilateral contract modifications. Contracts do not include grants and cooperative agreements covered by 31 U.S.C. 6301 et seq.

9. "Cost" means an amount as determined on a cash, accrual, or other basis acceptable to the Federal awarding or cognizant agency. It does not include transfers to a general or similar fund. (continued)

## OMB Circular A-87, Attachment A Definitions (continued)

10. "Cost allocation plan" means central service cost allocation plan, public assistance cost allocation plan, and indirect cost rate proposal. Each of these terms are further defined in this section.
  11. "Cost objective" means a function, organizational subdivision, contract, grant, or other activity for which cost data are needed and for which costs are incurred.
  12. "Federally-recognized Indian tribal government" means the governing body or a governmental agency of any Indian tribe, band, nation, or other organized group or community (including any native village as defined in Section 3 of the Alaska Native
- (continued)

# OMB Circular A-87, Attachment A Definitions (continued)

Claims Settlement Act, 85 Stat. 688) certified by the Secretary of the Interior as eligible for the special programs and services provided through the Bureau of Indian Affairs.

13. "Governmental unit" means the entire State, local, or federally-recognized Indian tribal government, including any component thereof. Components of governmental units may function independently of the governmental unit in accordance with the term of the award.
  14. "Grantee department or agency" means the component of a State, local, or federally-recognized Indian tribal government which is responsible for the performance or administration of all or some part of a Federal award.
- (continued)

# OMB Circular A-87, Attachment A Definitions (continued)

15. "Indirect cost rate proposal" means the documentation prepared by a governmental unit or component thereof to substantiate its request for the establishment of an indirect cost rate as described in Attachment E of this Circular.
16. "Local government" means a county, municipality, city, town, township, local public authority, school district, special district, intrastate district, council of governments (whether or not incorporated as a non-profit corporation under State law), any other regional or interstate government entity, or any agency or instrumentality of a local government.

(continued)



# OMB Circular A-87, Attachment A Definitions (continued)

17. "Public assistance cost allocation plan" means a narrative description of the procedures that will be used in identifying, measuring and allocating all administrative costs to all of the programs administered or supervised by State public assistance agencies as described in Attachment D of this Circular.
18. "State" means any of the several States of the United States, the District of Columbia, the Commonwealth of Puerto Rico, any territory or possession of the United States, or any agency or instrumentality of a State exclusive of local governments.

# OMB CIRCULAR A-87, Attachment A

## Basic Guidelines

Ten factors affecting allowability of costs.

Costs must:

1. Be necessary and reasonable for proper and efficient performance and administration
2. Be allocable
3. Be authorized or not prohibited by state or local laws or regulations
4. Conform to any limitations or exclusions set forth in A-87, Federal laws, terms of the Federal award or other regulations

(continued)

# **OMB CIRCULAR A-87, Attachment A**

## **Basic Guidelines**

### **Ten factors affecting allowability of costs. (continued)**

5. Be consistent with policies
6. Be accorded consistent treatment
7. Be in accord with GAAP
8. Not be included as a cost or used to meet cost sharing or matching requirements of any other Federal award
9. Be net of all applicable credits
10. Be adequately documented

# OMB Circular A-87, Attachment A

## Basic Guidelines

### Reasonable Costs

- ❧ 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 shall be given to:

(continued)

# **OMB Circular A-87, Attachment A**

## **Basic Guidelines**

### **Reasonable Costs (continued)**

- a. 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.
- b. The restraints or requirements imposed by such factors as: sound business practices; arms length bargaining; Federal, State and other laws and regulations; and, terms and conditions of the Federal award.
- c. Market prices for comparable goods or services.  
(continued)

# **OMB Circular A-87, Attachment A**

## **Basic Guidelines**

### **Reasonable Costs (continued)**

- d. 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.
- e. Significant deviations from the established practices of the governmental unit which may unjustifiably increase the Federal award's cost.

# OMB Circular A-87, Attachment A

## Basic Guidelines

### Allocable Costs

- Goods or services must be allocated in accordance with relative benefits received
- All benefiting activities must receive an appropriate allocation of indirect costs
- Costs allocable to a particular Federal award may not be charged to other Federal awards to overcome fund deficiencies, to avoid restrictions imposed by law or terms of the  
(continued)

# **OMB Circular A-87, Attachment A**

## **Basic Guidelines**

### **Allocable Costs (Continued)**

Federal awards, or for other reasons. However, this prohibition would not preclude governmental units from shifting costs that are allowable under two or more awards in accordance with existing program agreements.

- Where indirect costs are to be charged to a Federal award, a cost allocation plan will be required as described in Attachments C, D and E.



# OMB Circular A-87, Attachment A

## Basic Guidelines

### Applicable Credits

- Receipts or reductions of expenditure-type transactions that offset or reduce expense items allocable to Federal awards as direct or indirect costs. Examples are:
  - Purchase discounts
  - Rebates or allowances
  - Recoveries or indemnities on losses
  - Insurance refunds or rebates
  - Adjustments of overpayments or erroneous charges (continued)

# **OMB Circular A-87, Attachment A**

## **Basic Guidelines**

### **Applicable Credits (continued)**

- To the extent that such credits accruing to or received by the governmental unit relate to allowable costs, they shall be credited to the Federal award either as a cost reduction or cash refund, as appropriate.

# OMB Circular A-87, Attachment A

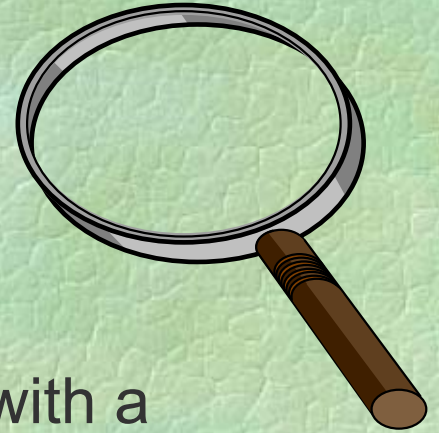
## Composition of Costs

1. Total cost. The total cost of Federal awards is comprised of the allowable direct cost of the program, plus its allocable portion of allowable indirect costs, less applicable credits.
2. Classification of costs. There is no universal rule for classifying certain costs as either direct or indirect under every accounting system. A cost may be direct with respect to some specific service or function, but indirect with respect to the Federal award or other final cost objective. Therefore, it is essential that each item of cost be treated consistently in like circumstances either as a direct or an indirect cost. Guidelines for determining direct and indirect costs charged to Federal awards are provided in the sections that follow. (continued)

**OMB Circular A-87**  
**Attachment A**  
**Composition of Costs (continued)**

Total Costs =  
Direct Costs  
Plus  
Indirect Costs  
Less  
Applicable Credits

# OMB Circular A-87 Attachment A Direct Costs



- Those costs that can be readily identified with a particular cost objective. Examples: (program specific)
  - Salaries,
  - Cost of materials acquired, consumed, or expended specifically for the purpose of the awards.
  - Space
  - Supplies
  - Communications (continued)

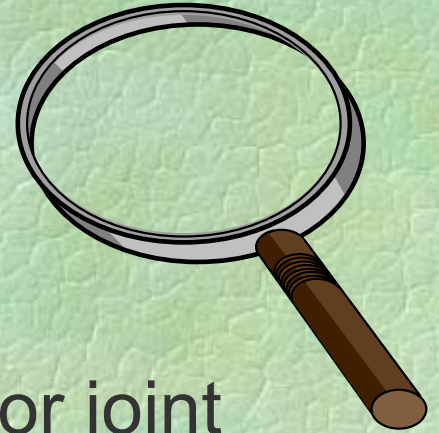
# **OMB Circular A-87**

## **Attachment A**

### **Direct Costs (continued)**

- Equipment and other approved capital expenditures
- Travel expenses incurred specifically to carry out the award

# OMB Circular A-87 Attachment A Indirect Costs



- Those costs incurred for a common or joint purpose benefiting more than one cost objective.
- Those costs which are not readily identifiable with a particular cost objective. Examples:
  - **Salaries**
  - **Space**
  - **Supplies**
  - **Communications (continued)**

# OMB Circular A-87, Attachment A

## Indirect Costs (continued)

- Those costs that originate in the grantee department, as well as those incurred by other departments in supplying goods, services and facilities.

### Note:

To facilitate equitable distribution of indirect expenses to the cost objectives served, it may be necessary to establish a number of pools of indirect costs within a governmental unit department or in other agencies providing services to a governmental unit department.  
(continued)



## OMB Circular A-87, Attachment A Indirect Costs (continued)

### Limitations on indirect or administrative costs.

- a. In addition to restrictions contained in this Circular, there may be laws that further limit the amount of administrative or indirect cost allowed.
- b. Amounts not recoverable as indirect costs or administrative costs under one Federal award may not be shifted to another Federal award, unless specifically authorized by Federal legislation or regulation.

# What is a Cost Allocation Plan? (CAP)

- A document that identifies, accumulates, and distributes allowable direct and indirect costs and declares the allocation methods used for distribution



# What is an Indirect Cost Rate? (ICR)

The ratio, expressed as a percentage, of an indirect cost pool and some direct cost base. Some might say it's:

***PBR (Pabst Blue Ribbon)***

**Pool/Base=Rate**



# Indirect Cost Rate

- Example:

Indirect Cost Pool = \$ 10,000

Distribution Base = \$100,000

**(Salaries & Benefits)**

Indirect Cost Rate = 10%

# Which organizations need to have an approved indirect cost rate?

**\$**Single Funding Source

Indirect cost rate not needed

**\$\$\$**Multiple Funding Sources

Indirect cost rate needed

# What purposes are served by having the rate?

- Management Information
- Compliance with Federal regulations; e.g., OMB Circulars A-87, A-21 & A-122
- Documentation for auditors

# Indirect Cost Rates

<b>Indirect Costs</b>		<b><u>\$150,000</u></b>	
<b>Direct Costs</b>			
<b>Salaries &amp; Wages</b>		<b>\$300,000</b>	
<b>Other Direct Cost</b>		<b><u>200,000</u></b>	
<b>Total Direct Cost</b>		<b><u>\$500,000</u></b>	
<b><u>\$150,000</u></b>			
<b>\$300,000</b>	<b>=</b>	<b>50%</b>	<b>Direct Labor</b>
<b><u>\$150,000</u></b>			
<b>\$500,000</b>	<b>=</b>	<b>30%</b>	<b>Total Direct Cost</b>

## OMB Circular A-87, Attachment A Required Certifications

- No cost allocation plan or indirect rate proposal shall be acceptable unless costs have been properly certified
  - Submitted to cognizant agency or maintained on file
  - Certificate must be signed by no less than the CFO of the governmental unit
  - Fed may disallow all indirect costs or
  - Unilaterally establish a plan or rate



# OMB Circular A-87, Attachment A Interagency Services

- The cost of services provided by one agency to another within the governmental unit may include allowable direct costs of the service plus a pro rate share of indirect costs. **A standard indirect cost allowance equal to ten percent of the direct salary and wage cost of providing the service (excluding overtime, shift premiums, and fringe benefits) may be used in lieu of determining the actual indirect costs of the service.**

# Important Fundamentals Underscored by A-87

- Need for documentation
- Consistency in the treatment of cost incurred in similar circumstances
- Identification and exclusion of unallowable costs

# Documentation

- Costs claimed must be supported by documentation validating both the service or material and amount charged.
- Personnel Compensation
- Reserves in internal service funds
- Cost allocation plans
- Indirect cost proposals
- Facility costs
- Equipment inventories
- Interest costs
- Cost transfers
- Consultants

# Points of Emphasis

**The Circular sets forth considerable detail on certain items of cost which had not been adequately covered in previous regulations.**

- ✓ Compensation
- ✓ Equipment and other capital expenditures
- ✓ Depreciation and Use Allowance
- ✓ Interest
- ✓ Taxes

# Compensation for Personnel Services

- Must be reasonable
- Must follow an appointment made in accord with the governmental unit's rules and meet Federal merit system requirements, if applicable
- Must be supported in accordance with subsection h. (support of salaries and wages) (continued)

# Compensation for Personnel Services(continued)

- Governmental unit's approved payroll is documentation for employees who work in a single indirect cost activity
- Semi-annual certifications are sufficient for employees who work solely on one Federal award (continued)

# Compensation for Personnel Services(continued)

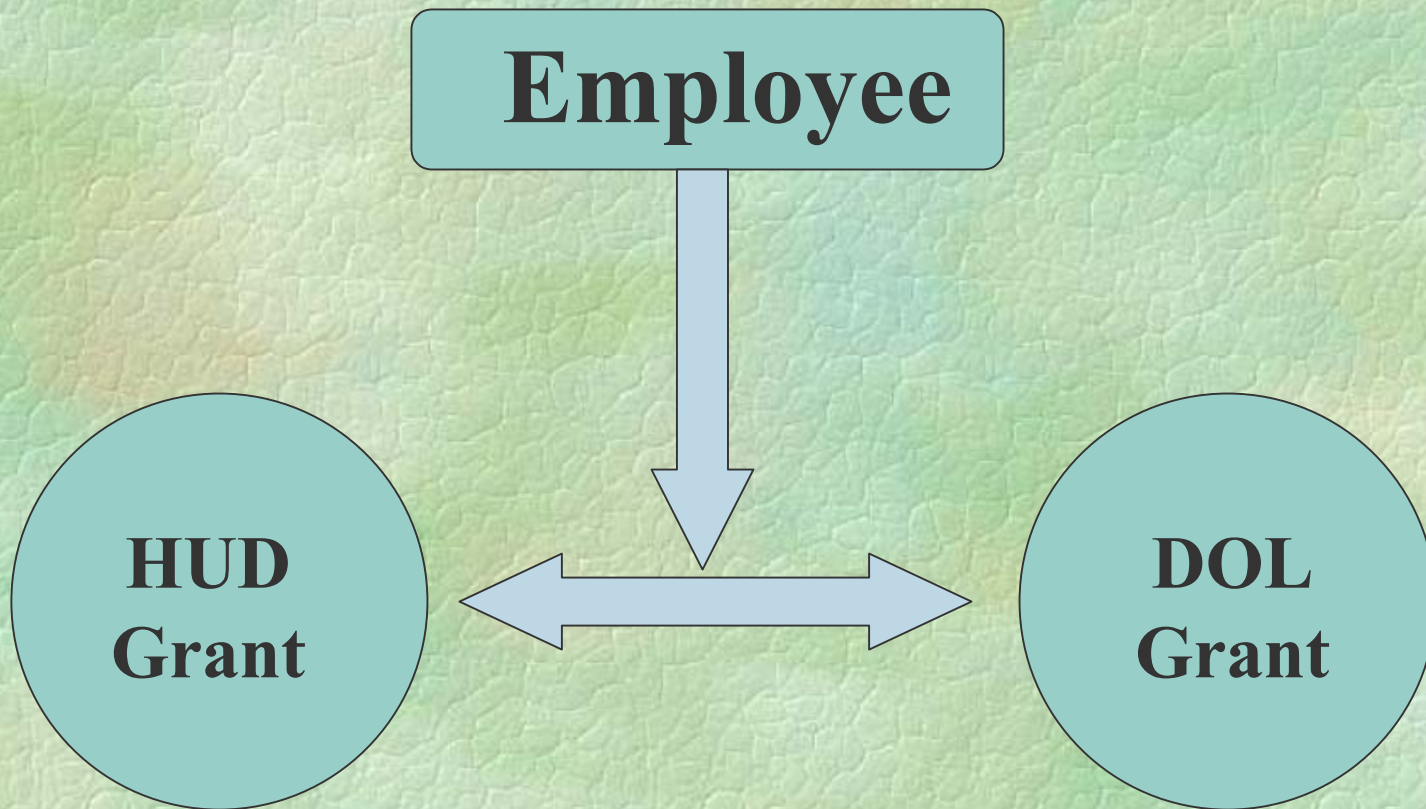
- PARs must meet the following standards
  - Reflect after-the-fact distribution of effort
  - Must account for total activity for which the employee is compensated
  - Be prepared at least monthly and coincide with one or more pay periods
  - Must be signed by the employee (continued)

# Compensation for Personnel Services (continued)

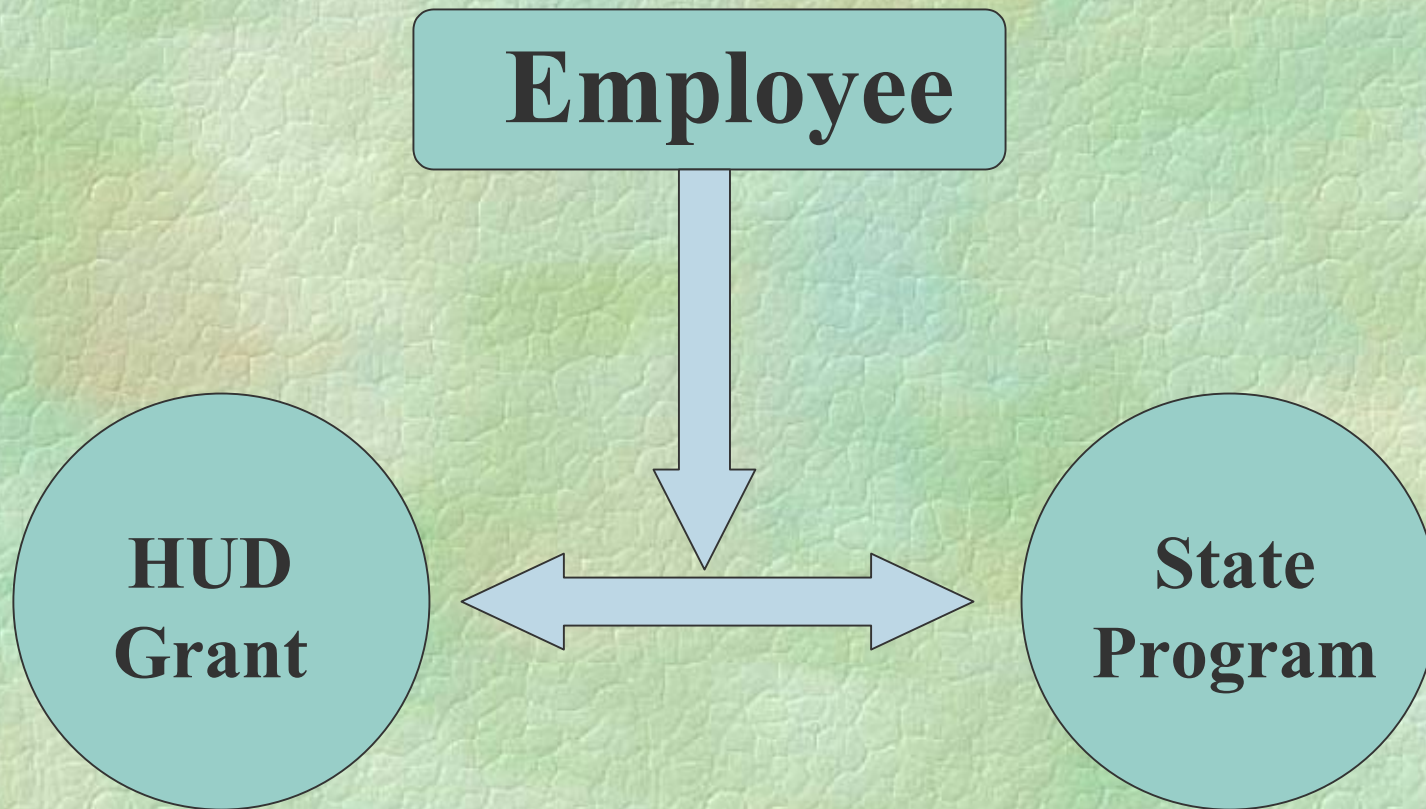
- PAR standards will apply where employees work on...



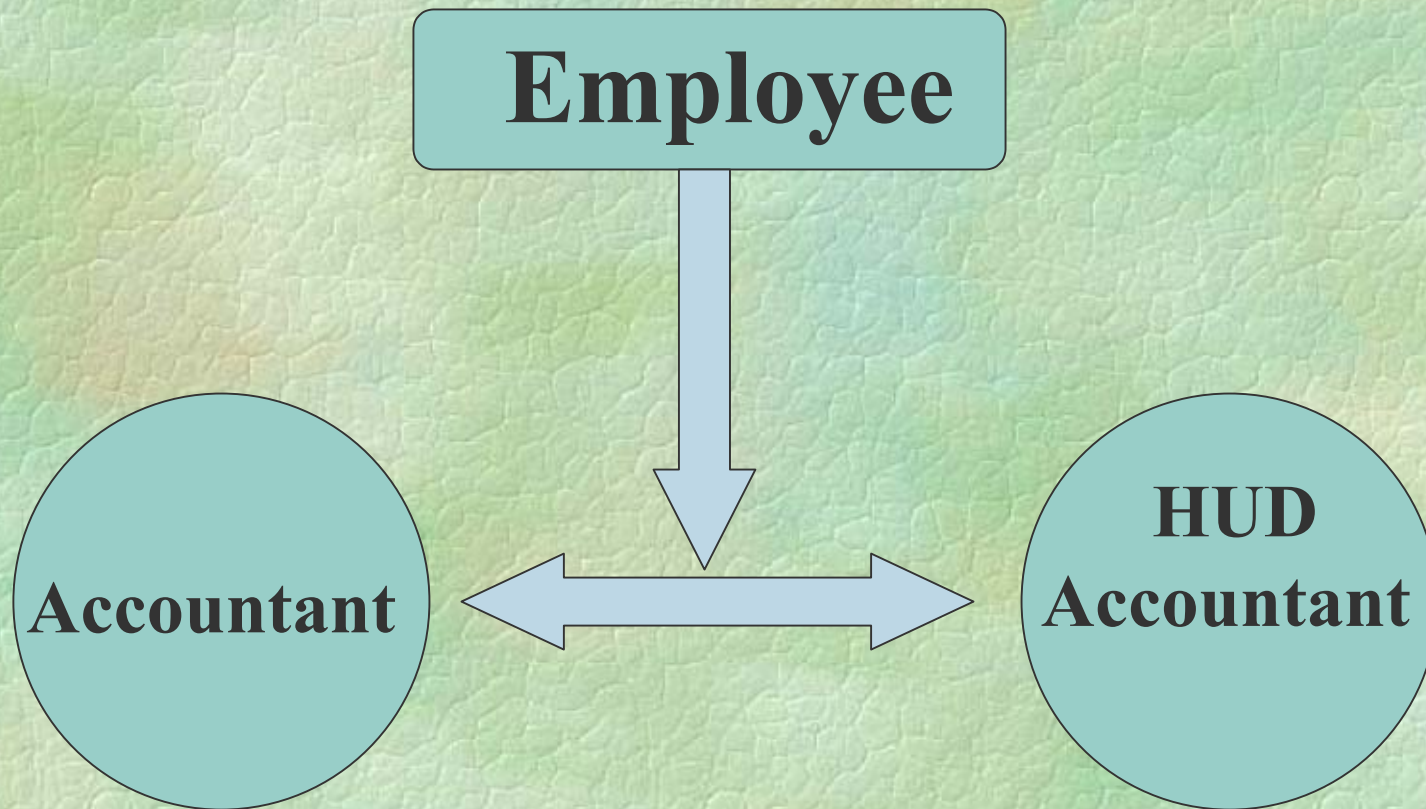
# More than one Federal award



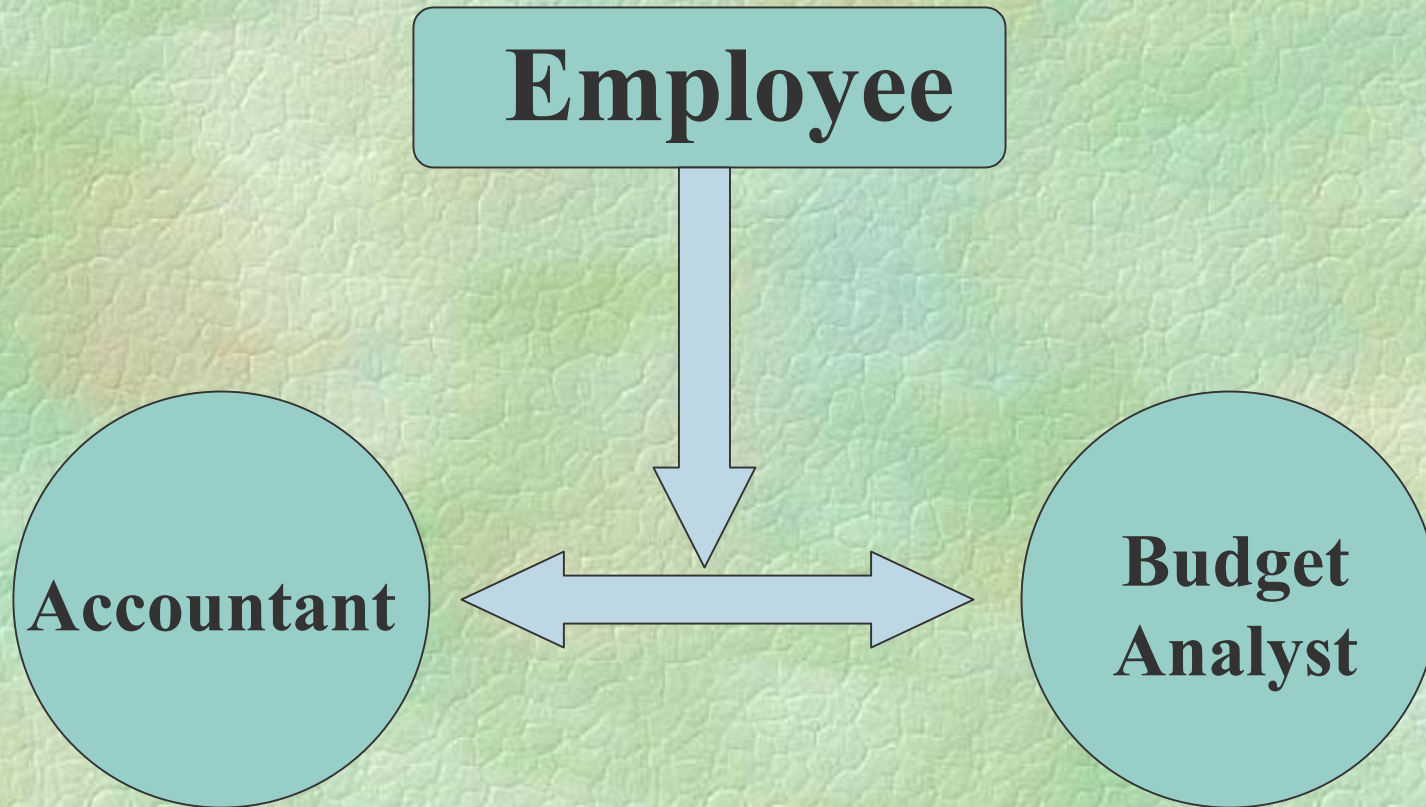
# A Federal award and a Non-Federal award



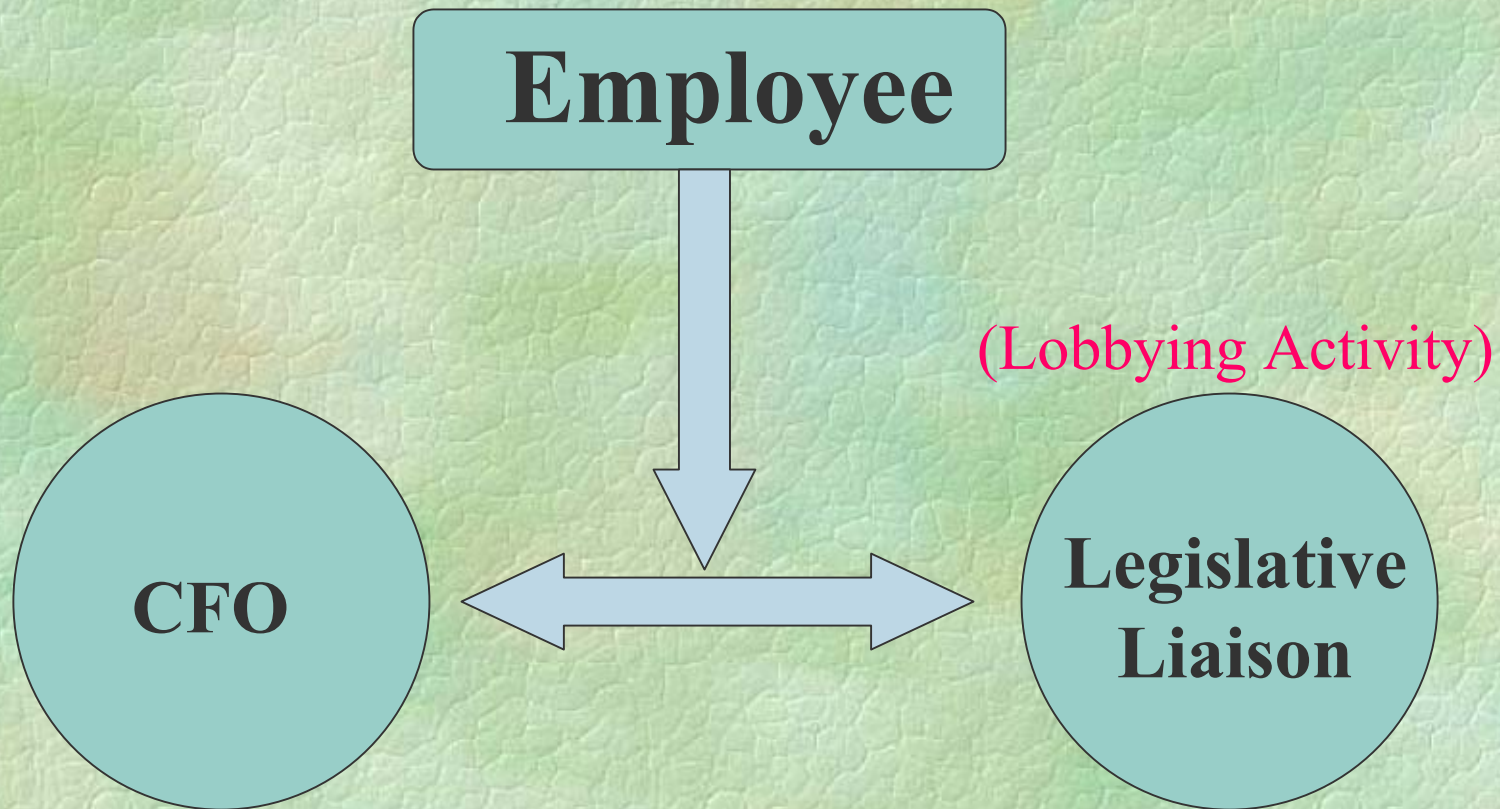
# An indirect cost activity and a direct cost activity



Two or more indirect activities which are allocated using different allocation bases



# An unallowable activity and a direct or indirect cost activity



# Equipment and other capital expenditures

- Threshold for capitalization of equipment (defining elements):
  - Article of non-expendable tangible personal property
  - Useful life of more than one year
  - Acquisition cost of lesser of:
    - \$5,000 or
    - Governmental unit's financial statement cap level (continued)

# Equipment and other capital expenditures(continued)

- "Capital expenditure" is defined as the cost of the asset including the cost to put it in place.
- "Other capital assets" is defined as buildings, land, and improvements to buildings or land, that materially increase their value or useful life.  
(continued)

# Equipment and other capital expenditures(continued)

- Direct charged equipment
  - Cost of less than \$5,000 is considered as supplies and may be expensed without Federal approval
  - Cost of greater than \$5,000 require prior Federal awarding agency approval (Fed awarding agency may waive or delegate)  
(continued)



# Equipment and other capital expenditures (continued)

- Indirectly charged equipment
  - Costs less than \$5,000 are considered supplies and may be immediately expensed
  - Costs of greater than \$5,000 may only be recovered through use allowance or depreciation methods

# Depreciation and Use Allowance

- Defined as means of allocating the cost of fixed assets to period benefiting from asset use
- Must be based on acquisition costs
- Generally, if depreciation is selected the straight line method must be used in absence of clear evidence of greater consumption in the earlier portions of asset life (continued)

# Depreciation and Use Allowance(continued)

- Computation of the cost must exclude:
  - Cost of land
  - Any portion of the cost of buildings or equipment borne by Fed
  - Any portion of the cost used to meet a matching requirement (continued)

# Depreciation and Use Allowance(continued)

- Permits "componentization" of buildings into separate groups of assets for the computation of depreciation
- A reasonable use allowance may be negotiated for any assets that are considered to be fully depreciated
- Building Use Allowance = 2%
- Equipment Use Allowance = 6.67%  
(continued)

# Depreciation and Use Allowance(continued)

- Charges must be supported by adequate property records
- Biennial physical inventories are required under either method selected (Statistical sampling allowed)

# Interest

- As of the effective date of the Circular:
- Financing costs (including interest) on building acquisition, construction, fabrication, reconstruction, or remodeling completed on or after October 1, 1980 is allowable.
- Financing cost (including interest) on allowable equipment is allowable regardless of acquisition date.

# Taxes

- Taxes that a governmental unit is legally required to pay are allowable, except for self-assessed taxes that disproportionately affect the Federal government
- Effective for the governmental unit's first fiscal year beginning on or after Jan 1, 1998

# Taxes (continued)

- Taxes that are in effect user fees for benefits provided to the Fed are allowable. (Gasoline taxes, motor pool fees, etc.)
- This provision does not restrict the authority of Federal agencies to identify taxes where Federal participation is inappropriate. (continued)



Questions?

