

**REVIEW GUIDE FOR  
NON PROFIT ORGANIZATION'S  
INDIRECT COST PROPOSALS**

U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES  
PROGRAM SUPPORT CENTER  
DIVISION OF COST ALLOCATION  
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**REVIEW GUIDE FOR  
NONPROFIT ORGANIZATIONS  
INDIRECT COST RATE PROPOSALS**

**I. INTRODUCTION:**

This review guide was developed to assist Division of Cost Allocation (DCA) staff in reviewing and negotiating indirect cost proposals for nonprofit organizations. The guide presents a number of ideas, facts and concerns that should be considered during the review of indirect cost proposals. Alternative approaches and allocation methods, including their strong and weak points are presented and discussed in detail. While this guide is reasonably detailed and comprehensive, it is not intended to be a substitute for professional experience and judgement.

The Office of Management and Budget (OMB) issues cost principles for all Federal agencies that sponsor research, training and other work at nonprofit organizations. OMB Circular A-122 establishes principles for determining costs applicable to grants and contracts with nonprofit organizations. The principles deal with the subject of cost determination and are designed to provide that the Federal Government bear its fair share of total allowable and allocable costs, except where restricted or prohibited by law. In general, the Circular defines the attributes associated with a nonprofit organization. It also provides general definitions regarding the applicability, allow ability and reasonableness of different types of costs. The Circular describes the different allocation bases that can be used by nonprofit organizations. Attachment B of Circular A-122 provides a list of "selected items of cost" and how these costs should be treated. There have been several revisions to the Circular since its inception on June 27, 1980. Prior to its inception, individual agencies issued their own cost principles with regard to nonprofit organizations. The most recent update of the Circular is dated June 1, 1998. Revisions also were made to Circular A-122 in the years 1984, 1987, 1995 and 1997. These revisions were widely disseminated to the nonprofit community and are considered Department policy. DCA staff should therefore be familiar with the revisions.

Indirect costs are those expenses that benefit common activities and therefore cannot be readily assigned to a specific cost objective or project. At nonprofit organizations, such costs normally are classified into one overall pool of costs. This pool is then divided by the allocation base the nonprofit organization has chosen in order to calculate a rate.

The preparation of an indirect cost proposal can be a significant undertaking for a nonprofit organization, that generally has to be done on an annual basis.

The decision that a cost proposal needs a more in-depth review and analysis by the DCA will be influenced by many factors. One purpose of this review guide is to help a negotiator identify factors that will help determine what type of review is necessary.

**II. REVIEW STEPS:**

**A. REQUIRED DOCUMENTATION**

<u>STEPS</u>	<u>COMMENTS</u>
<p>1. Determine whether the proposal package is complete, in sufficient detail to permit an adequate review, and is in a format that can be readily followed by the negotiator.</p> <p>2. Make sure that any information specifically requested by the DCA in prior correspondence or in advanced agreements established in previous negotiations is included in the proposal package.</p>	<p>The proposal package should include:</p> <ul style="list-style-type: none"><li>o The proposal itself. A separate column should be used for each direct activity (Federal grants, non-Federal grants, fund raising, etc.) of the organization. A separate column should also be used for indirect costs. These columns should show the type (e.g., labor, travel, supplies, etc.) and amount of costs incurred by each activity.</li> <li>o Audited financial statements.</li> <li>o A detailed and understandable reconciliation between the proposal and financial statements, showing each reclassification and adjustment to the financial statement accounts.</li></ul>

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STEPS

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COMMENTS

- o A "notice of grant award" or a "financial assistance award document" that shows the nonprofit organization has a current Federal award that is eligible to receive indirect costs. Training grants or grants where the amount of indirect costs is fixed (e.g., Dept. of Education, 8% training grant, etc.) do not meet this requirement. Also, DCA is not required to issue a rate that will be used strictly for "matching requirements" on grants.

**B. PRIOR NEGOTIATED WORK PAPERS**

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STEPS

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COMMENTS

While reviewing ask the following questions:

- a. When was the last time the nonprofit organization's indirect cost proposal was subjected to a thorough review and what were the results of that review?
  
- b. Were all corrections and adjustments that were made incorporated into the current proposal?
  
- c. Were fringe benefit, off-site or other special rates negotiated?
  
- d. Did the negotiation agreement contain any conditions? If so, has the organization complied with those conditions.

If this is the initial establishment of a rate for the nonprofit organization the negotiator should strive to set the tone for subsequent negotiations. Extra effort should be expended at this time to insure that the organization understands Federal requirements and that the organization's accounting system and method of operation can accommodate these requirements.

If the corrections were not made, appropriate adjustments should be made to the current proposal.

If these rates were established in the past, they will likely be needed in the future. Also, information provided by agency grant or contract offices may indicate a need for a special rate.

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STEPS

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COMMENTS

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e. If fixed rates were negotiated, does the carry-forward amount in the current proposal agree with the prior written carry-forward agreement?

f. Compare the submission with prior negotiations and identify any items in the proposal which appear unusual and are not discussed in the proposal package.

g. Determine whether the proposal requires an extensive review and/or site visit.

h. Perform a "math check" to ensure the accuracy of the organization's computations.

See the Trend Analysis section of this guide for more details regarding this requirement.

Normally a review of a nonprofit organization can be achieved without performing a site visit. Exceptions to this could be if the organization has multiple rates applicable to different functions or significant specialized service facilities, etc.

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STEPS

- i. Determine the type of rates to be negotiated.

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COMMENTS

A significant number of nonprofit organizations will have their rates negotiated on an annual basis using provisional/final type rates. However, nonprofit organizations can also negotiate predetermined rates when facts are sufficient for both parties to reach an informed judgement as to future rates.  
Note: An organization that has any Federal contracts cannot be given a predetermined rate (per an 11/10/82 GAO ruling).

**C. RECONCILE PROPOSAL TO THE FINANCIAL STATEMENTS**

Costs included on the proposal must be reconciled to the financial statements. A brief review of the financial statement itself can provide the negotiator with some insight regarding the nonprofits organizational structure, accounting system and costing methodologies. This can be helpful in the proposal review process. The reconciliation should be completed by the organization and submitted with their proposal. If the proposal has not been reconciled to the financial statements the nonprofit should be notified immediately. A review of the proposal should be delayed until this step is completed.

<u>STEPS</u>	<u>COMMENTS</u>
1. Reconcile the cost proposal to the audited financial statements.	The first step is to reconcile total costs, both allowable and unallowable, to the total costs shown on the audited financial statements.
2. Once the negotiator is assured that the total costs, direct and indirect, included in the indirect cost proposal agree with the audited financial statements, analyze the adjustments for unallowable and extraneous costs that should be excluded from the proposal, and those that should be allocated their share of indirect costs.	Unallowable and un-allocable costs (e.g., bad debts, fines, penalties, etc.) should always be eliminated from the indirect cost pool before the pool is allocated to each direct program. However, unallowable functions (e.g., fund raising, etc.) and non-reimbursable activities (e.g., donated labor or services that meet Circular A-122 requirements) should be treated as direct functions and receive their proper distribution of indirect costs. Indirect costs allocated to these functions are not reimbursed by the federal programs. To do this would dilute required matching ratios.

STEPS

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3. Analyze and verify the accuracy and necessity for adjustments and reclassifications.

COMMENTS

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The negotiator must understand every substantial reclassification and why it is taking place. Understanding this process is an important part of the proposal review.

D. ACCEPTABLE BASE (MTDC, SW, SW+FB)

STEPS

COMMENTS

1. Determine that the proposed base results in an equitable distribution of indirect costs.

The three most common bases used by nonprofit organizations are as follows:

a) Modified Total Direct Cost (MTDC):  
This base includes all direct costs incurred by the organization with the exception of distorting items such as, capital expenditures, subcontracts, flow through funds, etc.

b) Salaries and Wages (SW):  
This base includes only the direct salaries and wages incurred by the organization.

c) Salaries and Wages plus Fringe Benefits (SW+FB):  
This base includes only the direct salary and wages and the direct fringe benefits incurred by the organization.

2. Analyze and verify that the base the organization is proposing is consistent with the base they've used in previous submissions and on the rate agreement.

Generally, if the proposed base conforms to the suggested or required bases they should be accepted. However, there may be circumstances which indicates that an inequity will result if a suggested base is used. For example, an organization uses a modified total direct cost base, however, they have one grant that has a disproportionate amount of "other direct costs." This could distort the amount of indirect costs that are allocated to that program. Therefore, a salary and wage base might be more equitable.

Below are a few examples of possible inconsistencies a negotiator could encounter when reviewing a nonprofit organization's base:

- The organizations's previous rate agreement showed a base of salaries & wages including paid absences. However, the organization's proposal submission shows paid absences as part of the fringe benefit pool.

- The organization's previous rate agreement showed a base of salaries & wages including fringe benefits. However, the organization's proposal submission does not include fringe benefits in the base.

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STEPS

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COMMENTS

- The organizations's previous rate agreement showed a base of modified total direct costs that included the first \$25,000 of sub-awards in the base. However, the organization's proposal submission does not include any subcontractor costs in the base.

**E. TREND ANALYSIS**

A trend analysis of the nonprofit organization's indirect costs, rates, and allocation base should be performed during the preliminary review of each cost proposal. A trend analysis can be completed in a short period of time and frequently provides the negotiator with an insight into the areas of the proposal needing a more detailed review.

<u>STEPS</u>	<u>COMMENTS</u>
1. Perform a detailed trend analysis of the nonprofit organization's indirect costs, rates, and allocation base for the last three years, including the proposal year.	<p>A basic trend analysis is simply plotting the raw rate value of each indirect cost along with the applicable base involved. This provides the negotiator not only with a idea of where the rate is changing (e.g., increasing or decreasing), but should also indicate what items of costs a negotiator should spend time reviewing.</p> <p>It is very important for a negotiator to compare how much certain indirect costs are increasing when compared to the increases in the nonprofit organization's direct base.</p> <p>Here are a couple of examples regarding what might be discovered through trend analysis:</p> <ul style="list-style-type: none"><li>- An organization's direct cost base has increased by 5%, however, their indirect travel has increased by 40%. In this case it would be prudent for the negotiator to inquire about the large indirect travel increase.</li></ul>

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STEPS

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COMMENTS

- An organization's indirect supplies has increased 25% but its base has increased 30%. In this case although the indirect supplies have increased considerably they are still increasing at a slower rate than the base. This is a fairly normal occurrence and probably would not require any further inquiry by the negotiator.

**F. ALLOWABILITY, CONSISTENCY AND TREATMENT OF COSTS**

<u>STEPS</u>	<u>COMMENTS</u>
1. Determine whether the proposed costs benefit Federal awards.	Generally an expense that is necessary to the overall operation of the nonprofit organization is allocable to Federal awards. When there is a multi-tier distribution involving more than one pool, the criteria is; does the expense benefit all activities included in the particular distribution base?
2. Determine if the types of costs included in the indirect cost pool are consistently treated as indirect costs.	The nonprofit organization should be queried to determine whether any costs included in the indirect cost pool have also been charged to any Federal awards as direct costs. Where such costs are charged directly, they should be removed from the indirect cost pool except to the extent that they apply to indirect activities.
3. Review the proposal and financial statements to determine whether the indirect cost pool includes any unallowable costs.	Some examples of unallowable costs would include, alcoholic beverages, bad debts, contingencies, contributions and donations, entertainment, fines and penalties, fund raising, lobbying, etc.
4. Review the financial statements to determine if there are any applicable off-sets.	Income generated by the activities in the indirect cost pool and certain negative expenditure types of transactions should be used to off-set or reduce expenses in the indirect cost pool (e.g., parking fees, purchase discounts, etc.).

**G. CONCLUDING STEPS AND RATES**

<u>STEPS</u>	<u>COMMENTS</u>
1. Determine whether there are any anticipated significant changes in the level of the nonprofit organization's activities, its organizational structure, or its accounting system that should be taken into account in the negotiation of a provisional, fixed, or predetermined rate.	Normally this rate(s) is based on the actual costs for the most recently completed fiscal year. However, if the nonprofit organization anticipates significant changes in its operations that should affect the costs, the changes should be reflected in the establishment of the rate(s).
2. Determine whether an advances agreement covering future negotiations should be established.	Advanced agreements should be established when they are needed to preclude future disputes or problems or when they will help insure equitable cost determinations in the future. Examples of areas where these agreements may be needed include (a) changes or refinements in the allocation bases, (b) the treatment of certain types of costs, etc. If an advanced agreement is established it should be included in the letter transmitting the Negotiation Agreement.
3. Negotiate the appropriate type of rate(s) (e.g., provisional, fixed, predetermined, or final, etc.) and complete negotiation agreement form.	Contact should be maintained with the nonprofit organization throughout the proposal review. The negotiator at the conclusion of the negotiation, should contact the organization to (a) summarize the adjustments (if any) and the terms or conditions incident to the acceptance of the rate(s) and (b) gain concurrence on a final position.

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## STEPS

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## COMMENTS

Guidance on the circumstances under which costs should be negotiated on a provisional, final, fixed, or predetermined basis are as follows:

- Provisional rates will be used only in those situations in which the negotiator has little confidence in the rate proposed and cannot negotiate a rate which will fairly reflect the organization's operations during the period to which the rate applies. Provisional rates should also be used when (i) the propriety of the rates are contingent upon the occurrence of a future event which is uncertain at the time of negotiation or (ii) the organization plans to reorganize or otherwise substantially change its operations in the future. When a provisional rate is established, a final rate must be negotiated when the actual costs for the period become known.
  
- Predetermined rates may only be negotiated in those situations where there is a high probability that the rate negotiated will result in a dollar recovery to the organization not in excess of the amount that would have been recovered had the rate been established on an "after the fact" basis. Predetermined rates are not authorized if there are Federal contracts awarded to the organization.

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STEPS

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COMMENTS

- Fixed rates with carry forward provisions may be used except where the carry forward adjustment would be difficult or impossible to make because:

- (i) the organization is unlikely to have active awards in future periods to affect the carryforward adjustment,
- (ii) the mix of Federal/non-Federal work performed by the organization from year to year is too erratic to permit a fair carry-forward adjustment,
- (iii) the operating activities of the organization are unstable,
- (iv) the negotiator is not satisfied that the rate proposed will approximate the actual rate.

The negotiator should avoid setting fixed rates which result in major carry-forward adjustments. Consider setting limitations on the amount of permissible adjustments (e.g., spread over more than one fiscal year, etc.).

If a fixed, final or predetermined rate is used, a provisional rate would normally be established to cover the period subsequent to the period covered by the fixed, final or predetermined rate. This will preclude potential problems in funding awards made after the expiration of the fixed, final, or predetermined rate.

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STEPS

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4. Complete Summary of Negotiations

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COMMENTS

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A summary of negotiations should be prepared which shows the amounts negotiated that are different from the amounts submitted, and the reasons for the negotiated differences. The summary should be sufficiently detailed to permit an independent reviewer to quickly see and understand how the negotiated rates were computed.

**H. FILE DOCUMENTATION**

The negotiation workpaper files should contain sufficient documentation (e.g., file notes, schedules, interview notes, etc.) to clearly show:

- a. What aspects of the proposal were reviewed.
- b. What significant aspects of the proposal were not reviewed and why.
- c. What adjustments were made to the proposal and the reasons for the adjustments.
- d. How the approved rates were computed and negotiated.
- e. How any cost savings was computed.
- f. Required certifications.

## I. REFERENCE MATERIAL

- OMB Circular A-122, "Cost Principles for Non-Profit Organization."
- OMB Circular A-110, "Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals, and Other Non-profit Organizations."
- OMB Circular A-133, "Audits of States, Local Governments, and Non-Profit Organization."
- ASMB C-5, "A Guide for Nonprofits."
- Grants Administration Manual/Grants Policy Directives.
- 45 CFR Part 16, "Procedures of the Departmental Grants Appeals Board."
- 45 CFR Part 74, "Uniform Administrative Requirements for Awards and Subawards to Institutions of Higher Education, Hospitals, Other Nonprofit Organizations, and Commercial Organizations; And Certain Grants and Agreements with States, Local Governments and Indian Tribal Governments" - Departmental Implementing Regulations for OMB A-110.
- Internet Sites:
  - OMB Circulars - [www.whitehouse.gov/omb/grants/index.html](http://www.whitehouse.gov/omb/grants/index.html)
  - GASB Statements - [www.rutgers.edu/Accounting/raw/gasb/st/summary](http://www.rutgers.edu/Accounting/raw/gasb/st/summary)
  - FASB Statements - [www.rutgers.edu/Accounting/raw/fasb/st/summary](http://www.rutgers.edu/Accounting/raw/fasb/st/summary)
  - HHS Cost Policy Issuances (including ASMB C-5) - [www.hhs.gov/progorg/grantsnet](http://www.hhs.gov/progorg/grantsnet)
  - CFR Sections - [www.access.gpo.gov/nara/cfr/index.html](http://www.access.gpo.gov/nara/cfr/index.html)
  - DAB Decisions - [www.hhs.gov/dab/index.html](http://www.hhs.gov/dab/index.html)
  - Actuarial Standards of Practice - [www.actuary.org/standard.htm](http://www.actuary.org/standard.htm)

### **III. ALLOCATION METHODOLOGIES:**

There are three common allocation methodologies that a nonprofit organization can use to allocate costs. They are the "direct allocation method," the "simplified allocation method," and the "multiple allocation base method." These methods are defined as follows:

#### **A. DIRECT ALLOCATION METHOD**

This method should be used by nonprofit organizations that elect to charge their programs (e.g., grants) directly for all costs except those identified as "support services" costs. These nonprofit organizations usually separate their costs into two basic categories:

- (1) Program services - these include direct functions such as community service activities, research, education and training.
- (2) Supporting services - these include general administration and general expenses.

Joint costs such as depreciation, operation and maintenance, utilities, are prorated individually to each program (grant) or activity and to the supporting services (management and general) function. These costs will be allocated using an appropriate distribution base. The direct allocation methodology is acceptable provided each joint cost is prorated on a distribution base which is established in accordance with reasonable and consistently applied criteria, adequately supported by current data of the organization and, based on the benefits received. Examples of appropriate distribution bases along with how to employ this methodology are shown in document ASMB C-5 "A Guide For Nonprofits."

#### **B. SIMPLIFIED ALLOCATION METHOD**

This method should be used when all of the nonprofit organizations major functions benefit from a particular indirect cost expense by approximately the same degree. This method should also be used when a nonprofit organization has only one major function encompassing a number of individual projects (grants) or activities. Examples of appropriate distribution bases along with how to employ this methodology are shown in document ASMB C-5 "A Guide For Nonprofits."

### C. MULTIPLE ALLOCATION BASE METHOD

This method should be used when a nonprofit organization has several major functions which benefit from its indirect costs in varying degrees. Indirect costs are accumulated into separate cost groupings, such as groupings for general and administrative expenses, and a grouping for depreciation and other facility expenses. Each grouping should contain a pool of expenses that are of like character in terms of the functions they benefit and the allocation base which best measures the relative benefits provided to each function. Each grouping is then allocated individually to the benefitting functions by means of a base which best measures the relative benefits to each function. The number of separate groupings should be held within practical limits, taking into consideration the materiality of the amount involved and the degree of precision desired. Indirect cost allocated to each function are then distributed to individual awards and other direct activities included in that function by means of an indirect cost rate. Examples of appropriate distribution bases along with how to employ this methodology are shown in document ASMB C-5 "A Guide For Nonprofits."

It should be noted that most nonprofit organizations use either the "direct allocation method" or the "simplified allocation method."

**IV. Unallowable costs per Circular A-122, Attachment B:**

<u>STEPS</u>	<u>COMMENTS</u>
Review the proposal to determine whether the indirect cost pool includes any of the following unallowable costs:	The numbers next to each item refer to the section number in Circular A-122 which prescribe the handling of these costs. Unless otherwise noted, the references refer to Attachment B of Circular A-122.
a) Equipment and other capital expenditures (15.)	Capital expenditures are allowable as direct costs if they are approved by the awarding agency. They are not allowable as indirect costs but instead are recovered through depreciation or use allowance.
b) Alcoholic beverages (2.)	
c) Bad debts (3.)	
d) Contingency provisions (8.)	
e) Contributions (9.)	
f) Legal expenses for prosecution of claims against the Federal government (10.b.)	
g) Entertainment costs (14.)	
h) Fines and penalties (16.)	
i) Goods and services for personal use (18.)	
j) Fund raising (23.b.)	
k) Lobbying (25.)	
l) Losses on other awards (26.)	
m) Organization costs (31.)	
n) Selling and marketing (48.)	

V. Comments regarding certain "Selected Items of Cost":

These items are listed in Attachment B of Circular A-122

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STEPS

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COMMENTS

Bid and proposal costs

Per Circular A-122, the paragraph describing bid and proposal costs is "reserved." This means that until the Office of Management and Budget mandates a uniform Government wide policy, each Federal agency is permitted to apply its own policy for this cost. This provision is included in the HHS Grants Administration Regulations at 45 CFR 74.174(b) and in the HHS Procurement Regulations at 41 CFR 3-16.950-315A and reads as follows:

Bid and proposal costs are the immediate costs of preparing bids, proposals, and applications for potential Federal and non-Federal grants, contracts, and other agreements, including the development of scientific, cost, and other data needed to support the bids, proposals and applications. Bid and proposal costs of the current accounting period are allowable as indirect costs; bid and proposal costs of past accounting periods are unallowable as costs of the current period. However, if the organizations established practice is to treat these costs by some other method, they may be accepted if they are found to be reasonable and equitable. Bid and proposal costs do not include independent research and development costs or pre-award costs.

To verify the legitimacy of bid and proposal costs a negotiator should ask for a list of all employees who charged all or part of their time to B&P activities.

The following situations could cause concern:

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STEPS

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COMMENTS

a) Employee(s) who charge most of their time to a direct project and a small portion to B&P and/or employee(s) who charged most of their time in the previous year to a direct project are now charging most of their time to B&P.

b) The nonprofit organization cannot document the actual B&P projects that the employees worked on.

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STEPS

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Compensation for personal services

Compensation is defined as:

All compensation paid currently or accrued by the organization for services of employees rendered during the period of the award. It includes, but is not limited to, salaries, wages, director's and executive committee member's fees, incentive awards, fringe benefits, pension plan costs, allowances for off-site pay, incentive pay, location allowance, hardship pay, and cost of living differential.

All types of compensation mentioned above are allowable as long as the costs are reasonable for the services rendered and conform to the established policy of the organization and are consistently applied to both Federal and non-Federal activities.

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COMMENTS

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A negotiator needs to be aware of the following issues:

a) Inconsistencies regarding how particular labor positions (e.g., bookkeepers, grants administrators, etc.) are allocated to different programs. Headstart programs will often pay directly for cost that negotiators would normally consider indirect (e.g., grants administrators, etc.). If this occurs a negotiator needs to make sure that "like positions" associated with non-Headstart programs are not being included in the indirect cost pool. Otherwise, Headstart will be paying for the same type of position twice (once directly and once through the indirect cost rate).

b) Compensation costs for non-reimbursable direct activities (e.g. fund raising, bridge funding, etc.) being classified as indirect costs. A negotiator can address this problem by requesting a list of employees by labor position who charged time indirect.

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STEPS

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Depreciation and use allowances

Depreciation or use allowance is an allowable cost as long as certain criteria are met. See Circular A-122 for a list of the criteria.

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COMMENTS

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A negotiator should be aware of the following things with regard to this item of cost:

- a) Make sure that no depreciation applicable to assets bought with Federal sponsored program funds or non-Federal (private industry, state grants, etc.) sponsored program funds are included in the proposal.
- b) Make sure no depreciation or use allowance is included in the proposal that is applicable to idle facilities.
- c) The unamortized portion of any equipment written off as a result of a change in capitalization levels may be recovered by continuing to claim the otherwise allowable use allowances or depreciation on the equipment, or by amortizing the amount to be written off over a period of years as negotiated with the Federal cognizant agency.

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STEPS

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Donations

Donated or volunteer services may be furnished to an organization by professional and technical personnel, consultants and other skilled and unskilled labor. The value of these services is not reimbursable either as a direct or indirect cost. The value of donated services utilized in the performance of a direct cost activity shall be considered in the determination of the organization's indirect cost rate and, accordingly, shall be allocated a proportionate share of applicable indirect costs when certain criteria are met. See Circular A-122 for a list of the criteria.

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COMMENTS

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Recent reviews and advisory comments from Federal agencies has determined that the direct cost for donated services for professional and non-professional personnel does not require a significant allocation of Facilities & Administration Cost [F & A COST]. The Federal agencies involved in the cost reimbursement will no longer reimburse F & A Cost [Indirect Cost] for donated services to grantees.

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STEPS

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COMMENTS

Fringe benefits

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

2) Fringe benefits in the form of employer contributions or expenses for social security, employee insurance, workmen's compensation insurance, pension plan costs, and the like, are allowable, provided such benefits are granted in accordance with established written organization policies. Such benefits whether treated as indirect costs or as direct costs, shall be distributed to particular awards and other activities in a manner consistent with the pattern of benefits accruing to the individuals or group of employees whose salaries and wages are chargeable to such awards and other activities.

There are two different methods an organization can use to allocate fringe benefit costs. They are as follows:

Specific identification method:

This method involves "specifically assigning" the actual fringe benefit costs incurred by a "particular employee" to that "particular employee."

Fringe benefit rate(s):

This method involves developing a rate(s) for all employees in the organization. The rate could be the same for everyone or there could be several different rates depending on the employees job classification (e.g., professional, clerical, etc.).

The rate is calculated by taking the total fringe benefit costs incurred and dividing that amount by the total salary and wage costs incurred for the total organization or the class of employees for which you are developing a rate.

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STEPS

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COMMENTS

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

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

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STEPS

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COMMENTS

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

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

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STEPS

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Idle facilities and idle capacity

For this particular item of cost, the following terms have the meanings set forth below:

Facilities means land and buildings or any portion thereof, equipments individually or collectively, or any other tangible capital asset, wherever located, and whether owned or leased by the organization.

Idle facilities means completely unused facilities that are in excess to the organization's current needs.

Idle capacity means the unused capacity of partially used facilities.

Costs of idle facilities or idle capacity means costs such as maintenance, repair, housing, rent, and other related costs, e.g., property taxes, insurance, and depreciation or use allowance.

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COMMENTS

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If a negotiator identifies idle facilities they should inform the grantee of the requirements under Circular A-122.

The negotiator should then set a time frame regarding when the organization would need to vacate the space if it remains unoccupied.

When making this determination the negotiator needs to understand that the cost of idle facilities is unallowable except to the extent that:

1) They are necessary to meet fluctuations in work load.

2) They were necessary when acquired and are now idle because of changes in work requirements and efforts to achieve economical operations could not be foreseen.

General speaking with regard to this situation the organization will be given a reasonable period of time, ordinarily not to exceed one year to dispose of such facilities.

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STEPS

Independent research and development

Per Circular A-122, the paragraph describing Independent research and development cost is "reserved." This means that until the Office of Management and Budget mandates a uniform Government wide policy, each federal agency is permitted to apply its own policy in this area. DHHS has elected to continue its long standing policy for this cost. This provision is included in the HHS Grants Administration Regulations at 45 CFR 74.174(b) and in the HHS Procurement Regulations at 41 CFR 3-16.950-315A.

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COMMENTS

Independent research and development is research and development that is not sponsored by Federal or non-Federal grants, contracts, or other agreements. Independent research and development shall be allocated its proportionate share of indirect costs on the same basis as the allocation of indirect costs to sponsored research and development. The costs of independent research and development, including its proportionate share of indirect costs, are unallowable.

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STEPS

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COMMENTS

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Interest

Interest costs are allowable (subject to specific conditions listed in Circular A-122) if they relate to debt incurred after September 29, 1995, to acquire or replace capital assets acquired after this date and used in support of sponsored agreements.

If an organization is claiming significant interest expense the negotiator should determine if the interest is allowable per Circular A-122, also, the negotiator should determine if additional provisions mentioned in Attachment B, Paragraph 23.a., of Circular A-122, are applicable.

It should be noted that costs incurred for interest on borrowed capital or temporary use of endowment funds, however represented, are unallowable.

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STEPS

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Fund raising

Fund raising costs include financial campaigns, endowment drives, solicitation of gifts and bequests, and similar expenses incurred solely to raise capital or obtain contributions. These costs are unallowable as indirect costs.

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COMMENTS

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Nonprofit organizations may have separate and distinct fund raising departments. These separate departments are often shown on the financial statements and make it easier for a negotiator to identify fund raising costs. When a negotiator sees salaries and wages associated with fund raising they need to make sure that an appropriate amount of "other costs" (e.g., telephone , postage, etc.) associated with fund raising have also been identified.

Other nonprofit organizations may not have separate and distinct fund raising departments. However, employees such as the Executive Director may devote part of their time to fund raising. A negotiator may want to request position descriptions of various employees to ensure that fund raising activities are classified properly, and where applicable, allocated an appropriate share of indirect costs.

Note: For purposes of computing an indirect cost rate, fund raising costs must be included in the base if they:

(1) include salaries of personnel, (2) occupy space, and (3) benefit from indirect costs.

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STEPS

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Investment management costs

Investment management costs include costs of investment counsel and staff and similar expenses incurred solely to enhance income from investments. These costs are unallowable as indirect costs.

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COMMENTS

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A negotiator should review the balance sheet of the organization and see what types of investments are disclosed. If the organization has a large investment portfolio, yet shows no investment management costs in their proposal, the negotiator may want to inquire further regarding the classification of these costs.

Note: For purposes of computing an indirect cost rate, investment management costs must be included in the base if they:  
(1) include salaries of personnel (2) occupy space, and (3) benefit from indirect costs.

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STEPS

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COMMENTS

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Participant support costs

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

These costs are allowable with the prior approval of the awarding agency.

Participant support costs are generally excluded from the base because these costs normally do not generate a significant amount of administrative costs and normally do not generate any facilities costs such as building maintenance and operations. However, if participant support costs incurred relate to training or other projects performed at the site of the nonprofit organization and utilize either owned or rental facilities, a negotiator should determine whether or not the participant support costs should be excluded from the base.

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STEPS

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COMMENTS

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Rental costs

Rental costs are allowable, however, they are subject to several conditions. A brief description of these conditions are as follows:

a) Rental costs should be reasonable and consistent with that of comparable properties fair market value.

b) Rental costs under sale leaseback arrangements are allowable only up to the amount that would be allowed had the organization continued to own the property.

c) Rental costs under less than arms length leases are allowable only up to the amount that would be allowed had title to the property vested in the organization.

Rental costs are allowable both as direct or indirect costs for reimbursement on Federal awards. However, great care should be exercised to ensure that rental cost incurred by the organization are comparable to existing facilities in that general locale.

Negotiators need to be aware of less common rental arrangements. Examples of these are "sale and leaseback" or rental costs that create material equity in the leased property, both would be subject to ownership cost if:

a) an organization that owns a facility/building sells to a related/unrelated entity and then rents/leases back that same facility, or

b) if the lease arrangement creates a material equity such as a noncancellable lease with a bargain purchase option, one in which a lower purchase price (e.g., below market value) is fixed at the inception of the lease or the lease term exceeds 75% of the economic life of the facility.

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STEPS

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d) Rental costs under leases which are required to be treated as capital leases under GAAP, are allowable only to the amount that would be allowed had the organization purchased the property on the date the lease agreement was executed (e.g., to the amount that minimally would pay for depreciation or use allowance, maintenance, taxes, and insurance). See Circular A-122 for a more expansive definition of this condition.

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COMMENTS

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A negotiator needs to verify if an organization enters into a lease that is considered to be less than an arms length transaction, per Circular A-122 definition, such as, one with common board member(s), or officer(s), or between subsidiary and parent company.

These types of arrangements represent joint/common ownership the purpose of which could be to exercise control over the lessor in fixing the occupancy/rental charge.

Negotiators must ensure that the lessor/lessee relationship is independent of one another by asking questions relative to occupancy/rental costs.

For all of the above cited conditions, if ownership is established then ownership costs, such as depreciation/use allowance, maintenance, taxes, insurance and qualifying interest expense would be allowed and any rental cost included in the indirect cost proposal that is in excess of ownership costs would be disallowed.

## **VI. OTHER AREAS:**

### **Nonprofit organizations associated with hospitals and universities**

Nonprofit organizations can be affiliated with other types of organizations. These affiliations could be in the form of space being occupied on the premises of an affiliate, administrative costs of a nonprofit organization being handled by the affiliate or other types of arrangements. Below are some issues that a negotiator should be aware of when negotiating with nonprofit organizations affiliated with hospitals and universities.

1) If a nonprofit organization is affiliated with a hospital the following issues need to be addressed regarding space and administrative costs.

#### **- SPACE**

If a nonprofit organization is occupying space owned by the hospital the negotiator needs to determine who is paying for the space costs that the nonprofit organization is occupying. If the nonprofit organization is claiming space costs (e.g., rent expense, etc.) in their proposal the negotiator needs to request a copy of the hospital's Medicare cost report. This report should show an adjustment for space costs claimed by the hospital to take into account the space occupied by the nonprofit organization. If the negotiator does not see an adjustment in the Medicare cost report then the space costs related to the nonprofit organization could be getting reimbursed twice. Once by Medicare and once through the nonprofit organization's indirect cost rate.

#### **- ADMINISTRATION**

If a nonprofit organization includes costs in their proposal that they paid to the hospital to handle administrative functions of the nonprofit (e.g., payroll, etc.) the negotiator needs to request a copy of the hospital's Medicare cost report. This report should show an adjustment for administrative costs claimed by the hospital to take into account the reimbursement for administrative services paid to the hospital by the nonprofit organization. If the negotiator does not see an adjustment in the Medicare cost report then the administrative costs relating to the nonprofit organization could be getting reimbursed twice. Once by Medicare and once through the indirect cost rate.

## **Nonprofit organizations associated with hospitals and universities (continued)**

2) If a nonprofit organization is affiliated with a university the following issues need to be addressed regarding space and administrative costs.

### **- SPACE**

If a nonprofit organization is occupying space owned by the university the negotiator needs to determine who is paying for the space costs that the nonprofit organization is occupying. If the nonprofit organization is claiming space costs (e.g., rent expense, etc.) in their proposal the negotiator needs to contact an official of the university to see how the university is classifying the space. If DCA negotiates rates with the university the negotiator should review the universities previous indirect cost proposal submission. The proposal submission should show an adjustment for space costs claimed by the university to take into account the space occupied by the nonprofit organization. If the negotiator does not see an adjustment in the universities proposal then the space costs associated with the nonprofit organization could be getting reimbursed twice. Once through the universities indirect cost rate and once through the nonprofit organization's indirect cost rate.

### **- ADMINISTRATION**

If a nonprofit organization includes costs in their proposal that they paid to the university to handle administrative functions of the nonprofit (e.g., payroll etc.) the negotiator needs to contact an official of the university to see if the university is offsetting their administrative costs by the amount paid to them by the nonprofit organization. If DCA negotiated rates with the university the negotiator should review the universities previous indirect cost proposal. The proposal should show an adjustment which takes into account the reimbursement for administrative services paid to the university by the nonprofit organization. If the negotiator does not see an adjustment in the universities indirect cost proposal then the administrative costs relating to the nonprofit organization could be getting reimbursed twice. Once through the universities indirect cost rate and once through the nonprofit organization's indirect cost rate.