

**UNITED STATES ENVIRONMENTAL
PROTECTION AGENCY
GUIDE ON HOW TO PREPARE
AN INDIRECT COST RATE PROPOSAL
FOR A NON-PROFIT ORGANIZATION**

TRAINEE GUIDE



June 19, 2006

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I. INTRODUCTION

Indirect Cost Rate Proposals

The indirect cost rate proposal is the documentation prepared by a grantee organization, in accordance with applicable federal cost principles, to substantiate its claim for the reimbursement of indirect costs. It is the rate calculation and the supporting schedules used to arrive at the indirect cost pool amount and the base calculations. The rate proposals are generally based on the most current financial data supported by the organization's audited financial statements.

For non-profit organizations, the federal agency with the largest dollar volume of awards with an organization will be designated as the cognizant agency for the negotiation and approval of the indirect cost rates unless other arrangements are made regarding cognizance. A non-profit organization which has not previously established an indirect cost rate with a federal agency shall submit its initial indirect cost proposal immediately after the organization is advised that an award will be made and, in no event, not later than three months after the effective date of the award. Organizations that have previously established an indirect cost rate with a federal agency shall submit a new indirect cost proposal to the cognizant agency within six months after the close of each fiscal year.

Authority

Office of Management and Budget (OMB) Circular A-122, "Cost Principles for Non-Profit Organizations," establishes the federal requirements for the determination of allowable and unallowable direct and indirect costs and the preparation of indirect cost proposals. The Circular is comprised of three attachments:

- ❖ Attachment A defines general cost principles, direct costs, indirect costs, describes methods of allocation of indirect costs, the determination of indirect cost rates, and the negotiation and approval of indirect cost rates,
- ❖ Attachment B provides principles to determine allowability/treatment of 56 selected items of cost, and
- ❖ Attachment C provides a list of non-profit organizations not subject to this Circular.

The purpose of OMB Circular A-122 is (1) to ensure that the federal government bears its fair share of costs (except where restricted or prohibited by law), (2) to identify allowable and unallowable costs for determining the actual cost of federal programs, and (3) to establish policies and procedures for indirect cost allocation plans.

General Principles for Determining Allowable Costs

The total cost of a federal award is the sum of the allowable direct and allocable indirect costs less any applicable credits. To be allowable under an award, costs must:

- ❖ Be necessary and reasonable for proper and efficient operation of the program and be allocable to the federal award under the provisions of the applicable circular.

- ❖ Conform to any limitations or exclusions set forth in the cost principles circulars, applicable laws and regulations or in the award as to types or amounts of cost items.
- ❖ Be consistent with policies and procedures that apply uniformly to both federally financed and other activities of the organization.
- ❖ Be accorded consistent treatment to all activities of the organization.
- ❖ Be determined in accordance with generally accepted accounting principles (GAAP) unless otherwise provided in the applicable circular, and be applied in a consistent manner.
- ❖ Not be included as a cost or used to meet cost sharing or matching requirements of any other federally financed program in either the current or a prior period.
- ❖ Be adequately documented.

Indirect Costs

Indirect costs are those costs that are incurred for common or joint purposes. These costs benefit more than one cost objective and cannot be readily identified with a particular grant, contract or other activity of the organization. After direct costs have been determined and assigned directly to federal awards and other activities as appropriate, indirect costs are those remaining to be allocated to benefited cost objectives. Indirect costs are normally charged to federal awards by the use of an indirect cost rate. An indirect cost rate is a method for determining fairly and conveniently what proportion of indirect cost each program should bear. It is the ratio between the total indirect expenses and some direct cost base.

General Concepts of Reasonable and Allocable Costs

A cost may be considered reasonable if the nature of the goods or services received and the amount reflect the action a prudent person would have taken under the circumstances and at the time the decision to incur the cost was made. The major considerations to determine if a cost is reasonable are:

- ❖ Whether the cost is of a type generally recognized as ordinary and necessary for the operation of the organization or the performance of the award.
- ❖ The restraints or requirements imposed by such factors as generally accepted sound business practices, arms length bargaining, federal and state laws and regulations, and terms and conditions of the award.
- ❖ Whether the individuals concerned acted with prudence in the circumstances, considering their responsibilities to the organization, its members, employees, and clients, the public at large, and the federal government.
- ❖ Significant deviations from the established practices of the organization, which may unjustifiably increase the award costs.

A cost is considered allocable to a particular cost objective if the goods or services involved are chargeable or assignable to the cost objective considering the relative benefits received. The following are also considerations when determining whether a cost is allocable:

- ❖ A cost is allocable to a particular cost objective, such as a grant, contract, project, service, or other activity, in accordance with the relative benefits received. A cost is allocable to a federal award if it is treated consistently with other costs incurred for the same purpose in like circumstances and if it:
 - a. Is incurred specifically for the award.
 - b. Benefits both the award and other work and can be distributed in reasonable proportion to the benefits received, or
 - c. Is necessary to the overall operation of the organization, although a direct relationship to any particular cost objective cannot be shown.
- ❖ Any cost allocable to a particular award or other cost objective under these principles may not be shifted to other federal awards to overcome funding deficiencies, or to avoid restrictions imposed by law or by the terms of the award.

II. HOW TO PREPARE AN INDIRECT COST RATE PROPOSAL

The process of preparing an indirect cost rate proposal is accomplished by following eight broad steps (1) review OMB Circular A-122, (2) organization review, (3) program identification, (4) prepare a cost policy statement, (5) review and reconcile financial statements, (6) prepare indirect cost proposal detail, (7) prepare an indirect cost rate calculation worksheet and determine type of rate, and (8) obtain cognizant agency approval

THE PROCESS

- Step 1 Review OMB Circular A-122
- Step 2 Organization Review
- Step 3 Program Identification
- Step 4 Prepare a Cost Policy Statement
- Step 5 Review and Reconcile Financial Statements
- Step 6 Prepare Indirect Cost Rate Proposal Detail
- Step 7 Prepare an Indirect Cost Rate Calculation Worksheet & Determine type of rate(s)
- Step 8 Obtain Cognizant Agency Approval

STEP # 1 REVIEW OMB CIRCULAR A-122

- Obtain a copy of OMB Circular A-122
- Review Attachment C
- Review Attachment A
- Identify and document cost items from Attachment B

STEP # 2 ORGANIZATION REVIEW

- Obtain or prepare an organization chart
- Determine which units are indirect functions
- Prepare a statement of duties for all units

STEP # 3 PROGRAM IDENTIFICATION

- Review federal and nonfederal outlays
- Prepare a listing of directly awarded grants and contracts by federal agencies

STEP # 4 PREPARE A COST POLICY STATEMENT

- Review current Cost Policy Statement
- Determine general accounting principles
- Determine cost allocation methodology
- Submit cost policy statement

STEP # 5 REVIEW AND RECONCILE FINANCIAL STATEMENTS

- Obtain Financial Statements
- Identify direct costs
- Assign direct costs
- Identify indirect costs
- Reconcile total costs
- Identify unallowable costs
- Eliminate unallowable costs
- Review adjustments and reclassifications
- Prepare a reconciliation worksheet

STEP # 6 PREPARE INDIRECT COST RATE PROPOSAL DETAIL

- Insert separate columns for direct and indirect activities
- Prepare a personnel cost allocation worksheet
- Prepare a fringe benefit allocation worksheet
- Allocate all cost elements
- Obtain certificate of indirect costs

STEP # 7 PREPARE AN INDIRECT COST RATE CALCULATION WORKSHEET & DETERMINE TYPE OF RATE (S)

- Determine base
- Prepare indirect cost rate calculation worksheet
- Determine type of indirect cost rate
- Determine whether a special indirect cost rate is necessary

STEP # 8 OBTAIN COGNIZANT AGENCY APPROVAL

- Review prior negotiated work papers
- Contact the cognizant agency
- Assemble indirect cost rate proposal package
- Present the proposal
- Complete summary of negotiation

Step 1. Review OMB Circular A-122, Cost Principles for Non-profit Organizations

- ❖ Obtain a copy of OMB Circular A-122, Cost Principles for Non-profit organizations. It is available at www.whitehouse.gov/omb/circulars/a122/a122_2004.pdf.
- ❖ Review Attachment C to ensure that the organization is subject to the provisions of OMB Circular A-122. If the organization is not subject to the provisions of OMB circular A-122, contact the cognizant agency for further guidance.
- ❖ Review Attachment A – General Principles to gain an understanding of basic considerations, direct costs, indirect costs, and allocation of indirect costs and determination of indirect cost rates as applicable to the organization.
- ❖ Identify and document the cost items from Attachment B that are relevant to the organization to determine their proper treatment per Circular A-122. When the paragraph describing the cost item is “reserved” it 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.

Step 2. Organization Review

- ❖ Obtain or prepare an organization chart explaining the various services and/or functions of each unit within the organization.
- ❖ Determine which units are indirect (administrative) functions of the organization and services that are allowable and allocable to federal grants (under OMB Circular A-122). The organization structure should be for the period for which the proposal applies.
- ❖ Prepare a statement showing the duties and/or responsibilities of all units to be submitted along with the organization chart in the indirect cost rate proposal package. Once this is submitted, only revisions need be submitted with subsequent proposals.

Step 3. Program Identification (Federal and Non -Federal Funding)

- ❖ Review the organization’s “Federal and Non-Federal Outlays” to determine the programs being funded for the period applicable to the proposal.
- ❖ Prepare a listing of directly awarded grants and contracts by federal agencies to include total dollar amount, period of performance, any restrictions or references to statutes or regulations and the indirect cost limitations (if any) applicable to each, such as, ceiling rates or amounts restricted by administrative or statutory regulations.

Step 4. Prepare a Cost Policy Statement

- ❖ Review the organization’s current Cost Policy Statement. If one does not exist, prepare a Cost Policy Statement to include the organization’s general accounting principles, description of the cost allocation methodology, and determination of cost pools and distribution bases.

- ❖ To determine the organization's documented general accounting principles, obtain and review internal accounting manuals, standard operating procedures, or other available financial management documentation. If none exist, interview key accounting and financial management personnel in order to document the organization's general accounting principles. Be sure to clearly identify and document the accounting principles employed (generally allowable costs must be determined in accordance with U. S. Generally Accepted Accounting Principles (GAAP) per paragraph A.2.e of Attachment A of OMB Circular A-122), basis of accounting, accounting period or fiscal year, the allocation bases for both direct and indirect costs, and specific internal controls over allocation of costs between federal and non-federal programs and direct and indirect costs.
- ❖ Review the organization's documented cost allocation methodology. If one does not exist, prepare a cost allocation methodology by reviewing any existing documentation and interviewing key accounting and financial management personnel as to the current process of allocating costs. Be sure to document the specific cost elements used, processes of accumulating costs in cost pools, and the bases used in distributing costs to various cost pools in order to determine the most appropriate cost allocation method (Direct Allocation Method, Simplified Allocation Method, or Multiple Allocation Method).

Allocation Methods

Direct Allocation Method - The Direct allocation method is used when the organization treats all costs as direct costs except general administration and general expenses. These organizations generally separate their costs into three basic categories: (i) general administration and general expenses, (ii) fund raising, and (iii) other direct functions (including projects performed under federal awards). Joint costs, such as depreciation, rental expense, operation and maintenance facilities, telephone expenses, and the like are prorated individually as direct costs to each category and to each award or other activity using a base most appropriate to the particular cost being prorated.

Simplified Allocation Method - The Simplified Allocation Method is used when (a) the organization's major functions benefit from indirect costs to approximately the same degree or (b) the organization has only one major function encompassing a number of individual projects or activities or (c) the level of federal awards to an organization is relatively small.

The *allocation* of indirect costs is accomplished by (1) classifying the total cost for the base period (usually the organization's fiscal year) as either direct or indirect and (2) dividing the total allowable indirect costs (net of applicable credits) by an equitable distribution base. The result is an indirect cost rate, which is used to distribute indirect costs to individual federal financial assistance programs.

Both the direct costs and the indirect costs *exclude* capital expenditures and unallowable costs. However, unallowable costs are included in the direct cost base (if they represent activities to which the indirect costs are properly allocable).

Multiple Allocation Base Method - The Multiple Allocation Base Method is used when the organization's indirect costs benefit its major functions in varying degrees. The indirect costs are accumulated into separate cost groupings, which are individually allocated to benefiting functions using a base which best measures the relative benefits. Commonly used by National Association with regional field offices.

- ❖ Review the organization's existing or newly developed Cost Policy Statement to determine that it establishes a clear understanding between the organization and the federal government as to what costs will be charged directly and what costs will be charged indirectly.
- ❖ Submit the Cost Policy Statement with the first proposal package. Subsequent proposals only identify changes made to the initial Cost Policy Statement. A sample Cost Policy Statement is presented in Appendix A.

Step 5. Review and Reconcile Financial Statements

- ❖ Obtain audited financial statements, if available, for the period for which the proposal applies.
- ❖ Identify direct costs from the listing of directly awarded grants and contracts prepared in Step 3 and review of the financial statements. These are the actual dollars spent on various programs and are incurred specifically for a particular program, i.e., a particular award, project, service, or other direct activity of an organization.
- ❖ Assign direct costs to federal awards and other activities as appropriate.
- ❖ Then identify those costs that are incurred for common or joint purposes, benefit more than one cost objective, and cannot be readily identified with a particular grant, contract or other activity of the organization. These are indirect costs and should be allocated to benefited cost objectives and charged to federal awards by the use of an indirect cost rate.
- ❖ Reconcile total costs, both direct and indirect costs, to the total costs shown on the financial statements. Ensure that total costs agree by cost element as well.
- ❖ Once the total costs, direct and indirect, included in the indirect cost proposal agree with the financial statements, identify unallowable and extraneous costs that should be excluded from the proposal, and those that should be allocated their share of indirect costs.
- ❖ Eliminate unallowable and unallocable costs (e.g., bad debts, fines, penalties, etc.) 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 OMB Circular A-122 requirements) should be treated as direct functions and receive their proper distribution of indirect costs. The following costs are unallowable costs and should not be included in the indirect cost pool:
 - Equipment and other capital expenditures (15)
 - Alcoholic beverages (2)
 - Bad debts (3)
 - Contingency provisions (8)
 - Contributions (9)
 - Legal expenses for prosecution of claims against the federal government (10)
 - Entertainment costs (14)
 - Fines and penalties (16)
 - Goods and services for personal use (18)
 - Fund raising (23)
 - Lobbying (25)
 - Losses on other awards (26)
 - Organization costs (31)
 - Selling and marketing (48)

Note: The numbers represent the section numbers of each item in OMB Circular A-122 Attachment B.

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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.

- ❖ Review the adjustments and reclassifications related to unallowable and unallocable costs for compliance with OMB circular A-122 requirements as identified in Step 1.
- ❖ Prepare a worksheet to show the reconciliation between the proposal and the financial statements, showing each reclassification and adjustment to the financial statements.

ABC ORGANIZATION

Year ended September 30, 20XX

Direct Program And Activities

<u>ELEMENTS OF COSTS</u>	<u>FINANCIAL STATEMENT</u>	<u>ADJUSTMENTS</u>	<u>TOTAL DIRECT COSTS</u>	<u>INDIRECT COSTS</u>	<u>TOTAL COSTS</u>
Salaries and wages	\$1,327,638	\$0	\$1,111,343	\$216,295	\$1,327,638
Fringe benefits	\$245,434	\$0	\$202,219	\$43,215	\$245,434
Subtotal labor	\$1,573,072	\$0	\$1,313,562	\$259,510	\$1,573,072
Contractual Services	\$245,420	\$0	\$245,420	\$0	\$245,420
Depreciation/Use allowance	\$41,582	\$0	\$0	\$41,582	\$41,582
Emergency asst. payments	\$72,859	\$0	\$72,859	\$0	\$72,859
Equipment rental and maint.	\$11,448	\$0	\$6,070	\$5,378	\$11,448
Equipment / Capital	\$48,215	-\$48,215	\$0	\$0	\$0
Equipment / Minor	\$546	\$0	\$546	\$0	\$546
Food costs	\$124,616	\$0	\$124,616	\$0	\$124,616
Insurance	\$12,554	\$0	\$8,759	\$3,795	\$12,554
Occupancy	\$129,314	\$0	\$126,285	\$3,029	\$129,314
Office supplies	\$32,540	\$0	\$19,602	\$12,938	\$32,540
Other expenses	\$36	-\$36	\$0	\$0	\$0
Postage	\$3,901	\$0	\$3,369	\$532	\$3,901
Professional fees	\$34,211	\$0	\$0	\$34,211	\$34,211
Program supplies	\$109,663	\$0	\$109,663	\$0	\$109,663
Printing	\$65,697	\$0	\$58,345	\$7,352	\$65,697
Renovations and improv.	\$16,470	-\$16,470	\$0	\$0	\$0
Telephone	\$29,013	\$0	\$20,068	\$8,945	\$29,013
Travel	\$71,292	\$0	\$66,364	\$4,928	\$71,292
Lobbying	\$10,000	-\$10,000	\$0	\$0	\$0
Subtotal non-labor	\$1,059,377	-\$74,721	\$861,966	\$122,690	\$984,656
TOTAL	\$2,632,449	-\$74,721	\$2,175,528	\$382,200	\$2,557,728

Step 6. Prepare Indirect Cost Rate Proposal Detail

- ❖ Using the worksheet prepared in Step 5, insert, along the Y-axis, a separate column showing each direct activity (federal grants, non-federal grants, fund raising, etc.) of the organization. Ensure that all directly awarded grants and contracts identified in

Step 3 is presented in a separate column. A separate column should also be inserted for indirect costs with sufficient detail to determine purpose and classification, including personnel costs and employee benefits.

- ❖ Prepare a personnel cost allocation cost worksheet that shows the estimated/actual salary costs for each federal and non-federal cost objective. The percentage of time per

position is spread under the appropriate cost objective, ensuring that 100 percent is

allocated for each position. In most non-profit organizations, personnel and fringe benefit costs account for a majority of total costs. Therefore, proper allocation of these costs is important when preparing an indirect cost rate proposal. For example ABC Organization identified all positions charged 100% to administrative functions and then allocated the remainder of salaries cost to direct programs as appropriate.

ABC Organization

Personnel Cost Allocation Worksheet

Listed below are the positions, functions, and budgeted annual salaries for the people who comprise the Administrative Services Pool. These positions are charged 100% to Administrative Services.

<u>Position</u>	<u>Function</u>	<u>Indirect Salaries</u>
Executive Director	General Management	\$48,754
Deputy Director	General Management	\$30,664
Administrative Assistant to Executive Director	General Management	\$21,566
Administrative Secretary / Personnel Officer	Clerical support to the Executive Director and Administrative Assistant responsible for personnel information	\$17,087
Finance Officer	Accounting and related activities	\$26,484
Bookkeeper	Accounting	\$20,797
Bookkeeper	Accounting	\$17,215
Bookkeeper / Payroll Clerk	Payroll accounting and general disbursements	\$ 16,560
Custodian	Cleaning	\$2,936
Receptionist	Switchboard / Clerical	\$14,232

		\$216,295
		=====

- ❖ Prepare a fringe benefit cost allocation worksheet along with a statement describing the organization’s fringe benefit policy. A statement such as *“Fringe benefits are accrued in the period incurred, including accrued leave if employees have an irrevocable right to be compensated during employment or upon termination of employment. Generally, the cost of annual leave is recognized when the employee earns it, and holiday and other types of leave are considered a cost to the extent of actual compensation to employee”* is acceptable.

The fringe benefit cost allocation worksheet should show the estimated/actual fringe benefit costs related to indirect salaries. The organization must have documented fringe benefit

policies that must be submitted with the proposal package to support fringe benefit costs charged directly and indirectly to federal programs. For example, ABC Organization identified actual fringe benefit costs paid that were associated with indirect salaries and then allocated the remainder to direct programs as appropriate.

ABC Organization

Fringe Benefit Cost Allocation Worksheet

Fringe benefits associated with the positions within the Administrative Services Pool are as follows:

Payroll taxes:

FICA (actual paid)	\$16,546	
State Unemployment (actual paid)	<u>\$ 1,145</u>	\$17,691
Health and Life Insurance (actual paid)		\$22,474
Retirement Plan (actual paid)		<u>\$ 3,050</u>
Total		<u>\$43,215</u>

The non-profits fringe benefit policies should be included with proposal submission

- ❖ Based on the cost allocation methodology documented in Step 4, allocate all cost elements as required in the worksheet prepared in Step 6.1 above. For example, ABC Organization has used the Direct Allocation Method and documented the following cost allocation methodology for specific cost elements identified.

ABC Organization			
<u>Elements of Cost</u>	<u>Direct</u>	<u>Indirect</u>	<u>Methodology of Allocation</u>
Contractual Services	X	X	Actual usage
Depreciation/Use Allowance		X	For depreciable assets purchased with non-federal funds
Emergency assistance payments	X		Direct cost
Equipment rental and maintenance	X	X	Actual usage
Capital Expenditures	X		Actual usage; otherwise recoverable through depreciation
Equipment / Minor	X	X	Actual usage
Food Costs	X		Direct Cost
Insurance		X	Actual usage
Occupancy	X	X	Actual usage - Central office repairs and utilities on basis of square footage used for program and administrative services
Office supplies	X	X	Program services and administrative office & janitorial supplies
Other expenses		X	Actual usage – other allowable administrative services

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Once costs have been allocated, the resulting worksheet should be presented as follows:

ABC Organization

Year ended September 30, 20XX

ELEMENTS OF COSTS	FINANCIAL		-----DIRECT PROGRAMS at-----				TOTAL DIRECT COSTS	INDIRECT COSTS	TOTAL COSTS
	STATEMENT	ADJUSTMENTS	ENVIRON. POLICY	POLL. PREV.	SOURCE REDUCT.	OUTREACH			
Salaries and wages	\$1,327,638	\$0	\$140,831	\$950,615	\$18,305	\$1,592	\$1,111,343	\$216,295	\$1,327,638
Fringe benefits	\$245,434	\$0	\$28,138	\$170,107	\$3,657	\$317	\$202,219	\$43,215	\$245,434
Subtotal labor	\$1,573,072	\$0	\$168,969	\$1,120,722	\$21,962	\$1,909	\$1,313,562	\$259,510	\$1,573,072
Contractual Services	\$245,420	\$0	\$3,493	\$207,770	\$34,157	\$0	\$245,420	\$0	\$245,420
Depreciation/Use allowance	\$41,582	\$0	\$0	\$0	\$0	\$0	\$0	\$41,582	\$41,582
Emergency asst. payments	\$72,859	\$0	\$52,809	\$0	\$20,050	\$0	\$72,859	\$0	\$72,859
Equipment rental and maint.	\$11,448	\$0	\$592	\$5,197	\$0	\$281	\$6,070	\$5,378	\$11,448
Equipment / Capital	\$48,215	-\$48,215	\$0	\$0	\$0	\$0	\$0	\$0	\$0
Equipment / Minor	\$546	\$0	\$0	\$0	\$546	\$0	\$546	\$0	\$546
Food costs	\$124,616	\$0	\$0	\$124,616	\$0	\$0	\$124,616	\$0	\$124,616
Insurance	\$12,554	\$0	\$92	\$8,209	\$85	\$373	\$8,759	\$3,795	\$12,554
Occupancy	\$129,314	\$0	\$24,637	\$100,956	\$459	\$233	\$126,285	\$3,029	\$129,314
Office supplies	\$32,540	\$0	\$1,794	\$13,317	\$3,649	\$842	\$19,602	\$12,938	\$32,540
Other expenses	\$36	-\$36	\$0	\$0	\$0	\$0	\$0	\$0	\$0
Postage	\$3,901	\$0	\$476	\$301	\$125	\$2,467	\$3,369	\$532	\$3,901
Professional fees	\$34,211	\$0	\$0	\$0	\$0	\$0	\$0	\$34,211	\$34,211
Program supplies	\$109,663	\$0	\$7,603	\$55,241	\$40,659	\$6,160	\$109,663	\$0	\$109,663
Printing	\$65,697	\$0	\$5,140	\$7,022	\$1,345	\$44,838	\$58,345	\$7,352	\$65,697
Renovations and improv.	\$16,470	-\$16,470	\$0	\$0	\$0	\$0	\$0	\$0	\$0
Telephone	\$29,013	\$0	\$5,788	\$13,331	\$349	\$600	\$20,068	\$8,945	\$29,013
Travel	\$71,292	\$0	\$7,298	\$56,553	\$2,513	\$0	\$66,364	\$4,928	\$71,292
Lobbying	\$10,000	-\$10,000	\$0	\$0	\$0	\$0	\$0	\$0	\$0
Subtotal non-labor	\$1,059,377	-\$74,721	\$109,722	\$592,513	\$103,937	\$55,794	\$861,966	\$122,690	\$984,656
TOTAL	\$2,632,449	-\$74,721	\$278,691	\$1,713,235	\$125,899	\$57,703	\$2,175,528	\$382,200	\$2,557,728

- ❖ Obtain a Certificate of Indirect Costs signed by the executive director or chief financial officer of the organization. The required certificate is presented in Appendix B.

Step 7. Prepare an Indirect Cost Rate Calculation Worksheet and determine type of rate (s).

- ❖ Determine a base that results in an equitable distribution of indirect costs. The three most common bases used by non-profit organizations are:
 - 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.
 - Salaries and Wages (SW): This base includes only the direct salaries and wages incurred by the organization.
 - 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.

There may be circumstances which indicate that an inequity will result if the determined base is used. For example, if an organization uses a modified total direct cost base, but has one grant with a disproportionate amount of “other direct costs,” the amount of indirect costs that are allocated to that program could be distorted. Therefore, a salary and wage base might be more equitable.

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Below are a few examples of possible inconsistencies in a non-profit organization's base:

- a. The organization'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.
- b. 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.
- c. The organization'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.

For both the Direct Cost Allocation Method and the Simplified Allocation Method, the *distribution base* is (1) total direct costs (excluding capital expenditures and other distorting items, such as flow-through funds, the portion of each subaward in excess of \$25,000, etc.), (2) direct salaries and wages, or (3) direct salaries and wages plus fringe benefits.

- ❖ Prepare an indirect cost rate calculation worksheet using the worksheet developed in Step 6.

ABC Organization

Indirect Cost Rate Calculation Worksheet

(1) If the non-profit organization uses Direct Salaries & Wages excluding fringe benefits as their Base their rate would calculate as follows:

<u>Indirect costs</u>	=	\$382,200	
Base (Direct S&W)	=	\$1,111,343	= 34.4%

(2) If the non-profit organization uses Direct Salaries & Wages including fringe benefits as their Base their rate would calculate as follows:

<u>Indirect costs</u>	=	\$382,200	
Base (Direct S&W + FB)	=	\$1,313,562	= 29.1%

(3) If the non-profit organization uses Modified Total Direct Costs (MTDC) as their Base their rate would calculate as follows:

<u>Indirect costs</u>	=	\$382,200	
Base (MTDC)	=	\$2,175,528	= 17.6%

- ❖ Determine the type of indirect cost rate to be negotiated (e.g., provisional, fixed, predetermined, or final, etc.). The circumstances under which costs should be negotiated on a provisional, final, fixed, or predetermined basis are as follows:
 - a. Provisional rates will be used only in those situations when there is little confidence in the rate proposed and the organization 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
 - b. Propriety of the rates is 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.

A GUIDE ON HOW TO PREPARE AN INDIRECT COST RATE PROPOSAL

- c. 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.

Because of legal constraints, predetermined rates are not permitted for federal contracts; they may, however, be used for grants or cooperative agreements per OMB Circular A-87. OMB Circular A-21

authorizes the use of predetermined rates in determining the indirect costs applicable under research agreements with educational institutions.

- d. Fixed rates with carry forward provisions may be used except where the carry forward adjustment would be difficult or impossible to make because:
- the organization is unlikely to have active awards in future periods to affect the carry forward adjustment
 - 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
 - the operating activities of the organization are unstable
 - the organization is not satisfied that the rate proposed will approximate the actual rate

If a fixed, final or predetermined rate was 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.

- ❖ Determine whether a Special Indirect Cost Rate is necessary.

A Special Indirect Cost Rate is used when a single indirect cost rate for all activities of a non-profit organization may not be appropriate because it may not take into account those different factors which may substantially affect the indirect costs applicable to a particular program or group of programs. The computation of an off-site indirect cost rate is necessary when a federal program is conducted by a non-profit organization at a location (off-site) other than its central office (on-site). Federal programs conducted at off-site locations may not benefit from the indirect cost pool to the same extent as programs conducted on-site at the central office. Hence, a Special Indirect Cost Rate should be developed to prevent an inequitable allocation of indirect costs to program(s) conducted at the off-site location.

Step 8. Obtain Cognizant Agency Approval

- ❖ Review prior negotiated work papers to determine that appropriate adjustments have been made to the current proposal and whether the last proposal had certain conditions that should be implemented in the current proposal. If this is the initial establishment of an indirect cost rate the organization should ensure that the organization understands federal requirements and that the organization’s accounting system and method of operation can accommodate these requirements.
- ❖ Contact the federal agency that provides the most funds (Cognizant Agency) regarding the procedures for submission, review and approval of indirect cost rates.
- ❖ Assemble indirect rate proposal package using the checklist provided as a guide. Be sure to include all supporting schedules and policy statements required.
- ❖ Present the proposal to the Cognizant Agency, documenting any meeting and/or telephone conversations and approvals, and making any agreed upon changes.

NOTE: In accordance with OMB Circular A-122, EPA requires that all non-profit organizations which have not previously established an indirect cost rate with a federal agency must submit to their cognizant agency their initial indirect cost proposal immediately after the organization is advised that an award will be made and, in no event, not later than three months after the effective date of the award. The address of EPA is at the end of this document. Once the proposal is received, it will be sent to the U.S. Department of the Interior, National Business Center, which reviews proposals from EPA's non-profit grantees.

- ❖ Complete Summary of Negotiations. Be sure to summarize the adjustments (if any) and the terms or conditions incident to the acceptance of the rate(s) and gain concurrence on a final position. 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.

III. INDIRECT COST PROPOSAL (ICP) CHECKLIST (Non-Profit Organizations)

Items required in an indirect cost rate proposal:

- Entity's written policy for allocating and identifying direct and indirect costs, i.e. cost allocation methodology. (Appendix A)
- Line item expenditure description (what costs are included in the line item) and how the cost is being allocated between direct and indirect.
- A schedule that summarizes total costs by line item expenditure which should include but not limited to:
 - Total expenditure (reconcilable to the audit if using actual numbers)
 - Exclusions
 - Direct costs
 - Indirect costs
 - Indirect cost rate calculation
- A breakdown of indirect salaries by position title and amount.
- Most recent audited financial statement and single audit reports. If Entity is under the A-133 threshold (\$500,000) and does not have an audit, then a copy of IRS Form 990 can be submitted instead.
- Entity's tax identification number or EIN (employer identification number).
- A copy IRS letter granting nonprofit status (1st year submission only).
- Most recent organization chart.
- Signed lobbying certificate (Appendix B).
- Signed certificate of indirect costs (Appendix C).
- A copy of the **3** most recent signed negotiation agreements (1st year submission only).
- Need to state the majority federal funding agency.
- Federal percentage – the approximate percentage of federal funding for each year a rate is proposed for.
- Need to state the treatment of paid absences (1st year submission only).
- Need to state the fiscal period for which a rate is proposed for.
- A list of subawards or subcontracts given out by the Entity.
- Contact person information (preferably the person who prepared the proposal):
 - Name
 - Position title
 - Email address (very important)
 - Phone & fax numbers
 - Entity's Internet website address if any

APPENDIX A

Cost Policy Statement - Example

ABC NON-PROFIT ORGANIZATION

General Accounting Policies

- a. Basis of Accounting - Accrual Basis
- b. Fiscal Period - July 1 through June 30
- c. Allocation Basis - Direct Allocation Basis
- d. Indirect Cost Rate Allocation Base - Direct Salaries and Wages Including Applicable Fringe Benefits.
- e. If the ABC non-profit organization needs a fringe benefit rate, it would describe its fringe benefit allocation base at this point
- f. ABC non-profit organization maintains adequate internal controls to insure that no cost is charged both directly and indirectly to federal contracts or grants.

Description of Cost Allocation Methodology

This proposal is for an indirect cost rate based on the non-profit's actual costs, for its fiscal year beginning July 1, 200X and ending June 30, 200X. The proposal is based on the non-profit organization's audit report (Statement of Functional Expense Statement) for the year ending June 30, 200X.

This proposal addresses all elements of cost incurred by "Name of Organization" and identifies shared costs that require allocation.

The non-profit treats all costs as direct costs except general administration and general expenses. Joint costs are prorated individually as direct costs to each category and to each award using a base most appropriate to the particular cost being prorated. Therefore, the direct allocation method has been used in allocating indirect costs.

Direct Costs

Direct costs are costs that can be identified specifically with a project and therefore are charged to that project. The accounting system records these costs as they are incurred within the series of accounts assigned for that purpose. Further distribution is not required.

Indirect Costs

Indirect costs are costs incurred for common or joint objectives and therefore cannot be readily and specifically identified with a particular project or activity. These costs are grouped into common pool(s) and distributed to benefiting activities by a cost allocation process.

Cost Pool and base for distribution

The ABC non-profit organization has created an Administrative Services Pool consisting of salaries, fringe benefits, and non-salary costs. The Administrative Services Pool is charged with all the indirect costs as defined above. The pool is distributed to the various program activities on the basis of direct salaries, including vacation, holiday, and sick pay but excluding other fringe benefits expended on those activities. Volunteers are included in the direct salaries total.

Volunteers involved in any direct activity of the organization are included in the direct salaries base because they meet the requirements outlined in OMB Circular A-122.

Elements of Cost/Methodology of Allocation

- a. Contractual Services/Actual usage.
- b. Depreciation, Use Allowance/Indirect cost.
- c. Emergency assistance payments/Direct cost.
- d. Equipment rental and maintenance/Rental and maintenance on equipment used in central office finance office.
- e. Equipment, Capital/Purchasing of office furniture for use in performing administrative services.
- f. Equipment, Minor/Actual usage.
- g. Food costs/Direct cost.
- h. Insurance/Actual usage.
- i. Occupancy, Central office repairs and utilities/basis of square footage used for administrative services.
- j. Office supplies/Office and janitorial supplies for administrative and program services.
- k. Other expenses/Based on administrative services actual use.
- l. Postage/Actual usage.
- m. Professional fees, Accounting and audit services, payroll-processing services, /charged on work performed for administrative services.
- n. Program supplies/Programs are charged to project as costs are incurred. Costs are direct costs.
- o. Printing/Actual usage.
- p. Renovations and improvements/Direct cost.
- q. Telephone/Basic services allocated on number of instruments, toll calls charged on basis of logs of such calls for administrative services.
- r. Travel/Charged based on actual administrative and program use of vehicles. Costs include mileage, transportation, per diem, gas, oil, repairs, and insurance on vehicles.

Allocation of costs should be accomplished on a cost benefit basis and the cost benefit can be different from one ABC non-profit organization to the next.

APPENDIX B

Lobbying Cost Certificate - Example

I hereby certify that the _____
(name of organization)

has complied with the requirements and standards on lobbying costs in Office of Management and
Budget Circular A-122 for the fiscal year ended _____
(fiscal year covered by indirect cost proposal)

Signature

Name

Title

Date

(Signed by the official having the authority to negotiate indirect cost rates for the organization or by a higher level official.)

**Note: The above certification is a requirement of OMB Circular A-122.
We will not be able to process your indirect cost proposal without this certification.**

APPENDIX C

Certificate of Indirect Costs - Example

This is to certify that I have reviewed the indirect cost rate proposal submitted herewith and to the best of my knowledge and belief:

- (1) All costs included in this proposal [**identify date**] to establish billing or final indirect costs rates for [**identify period covered by rate**] are allowable in accordance with the requirements of the Federal award(s) to which they apply and OMB Circular A-122, "Cost Principles for Non-Profit Organizations." Unallowable costs have been adjusted for in allocating costs as indicated in the cost allocation plan.

- (2) All costs included in this proposal are properly allocable to Federal awards on the basis of a beneficial or casual relationship between the expenses incurred and the agreements to which they are allocated in accordance with applicable requirements. Further, the same costs that have been treated as indirect costs have not been claimed as direct costs. Similar types of costs have been accounted for consistently and the Federal Government will be notified of any accounting changes that would affect the predetermined rate.

I declare that the foregoing is true and correct.

Organization: _____

Signature: _____

Name of Official: _____

Title: _____

Date of Execution: _____

APPENDIX D

Statement of Treatment of Paid Absences - Example

(A) Treatment of paid absences: Vacation, holiday, sick leave, 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 the salaries and wages. Separate claims for the costs of these paid absences are not made.

(B) Treatment of paid absences: The costs of vacation, holiday, sick leave pay and other paid absences are included in the organization's fringe benefit rate and are not included in the direct cost of salaries and wages. Claims for direct salaries and wages must exclude those amounts paid or accrued to employees for periods when they are on vacation, holiday, sick leave or are otherwise absent from work.

APPENDIX E

Negotiated Indirect Cost Rate Agreement - Example

EIN #:

Organization:

Date:

ABC NON-PROFIT ORGANIZATION
11100 Wildlife Center Drive
Reston, Virginia 20190-5362

Report No.

Filing Ref.: Initial Negotiation Agreement

The indirect cost rates herein are for use on grants and contracts with the federal government to which Office of Management and Budget Circular A-122 applies, subject to the limitations in Section II of this agreement. The rates are negotiated by the U.S. Department of the Interior, National Business Center, on behalf of the U.S. Environmental Protection Agency, Grants Administration Division, and the subject organization in accordance with the authority contained in the Circular.

Section I: Rates

Type	Effective Period		Rate*	Locations	Applicable To
	From	To			
Final	09/01/02	08/31/03	10.95%	All	All Programs
Provisional	09/01/03	08/31/04	10.95%	All	All Programs
Provisional	09/01/04	08/31/05	10.95%	All	All Programs

*Base: Total direct costs, less capital expenditures and subawards greater than \$25,000.
Treatment of fringe benefits: Fringe benefits applicable to direct salaries and wages are treated as direct costs; fringe benefits applicable to indirect salaries and wages are treated as indirect costs.

Section II: General

- A. Limitations: Use of the rates contained in this agreement is subject to any applicable statutory limitations. Acceptance of the rates agreed to herein is predicated upon these conditions: (1) no costs other than those incurred by the subject organization were included in its indirect cost rate proposal, (2) all such costs are the legal obligations of the grantee/contractor, (3) similar types of costs have been accorded consistent treatment, and (4) the same costs that have been treated as indirect costs have not been claimed as direct costs (for example, supplies can be charged directly to a program or activity as long as these costs are not part of the supply costs included in the indirect cost pool for central administration).
- B. Audit: All costs (direct and indirect, federal and non-federal) are subject to audit. Adjustments

to amounts resulting from audit of the cost allocation plan or indirect cost rate proposal upon which the negotiation of this agreement was based will be compensated for in a subsequent negotiation.

- C. Changes: The rates contained in this agreement are based on the organizational structure and the accounting system in effect at the time the proposal was submitted. Changes in organizational structure, or changes in the method of accounting for costs which affect the amount of reimbursement resulting from use of the rate in this agreement, require the prior approval of the responsible negotiation agency. Failure to obtain such approval may result in subsequent audit disallowance.
- D. Provisional/Final Rates: Within 6 months after yearend, a final rate must be submitted based on actual costs. Billings and charges to contracts and grants must be adjusted if the final rate varies from the provisional rate. If the final rate is greater than the provisional rate and there are no funds available to cover the additional indirect costs, the organization may not recover all indirect costs. Conversely, if the final rate is less than the provisional rate, the organization will be required to pay back the difference to the funding agency.
- E. Agency Notification: Copies of this document may be provided to other federal offices as a means of notifying them of the agreement contained herein.
- F. Record Keeping: Organizations must maintain accounting records that demonstrate that each type of cost has been treated consistently either as a direct cost or an indirect cost. Records pertaining to the costs of program administration, such as salaries, travel, and related costs, should be kept on an annual basis.
- G. Reimbursement Ceilings: Grantee/contractor program agreements providing for ceilings on indirect cost rates or reimbursement amounts are subject to the ceilings stipulated in the contract or grant agreements. If the ceiling rate is higher than the negotiated rate in Section I of this agreement, the negotiated rate will be used to determine the maximum allowable indirect cost.
- H. Use of Other Rates: If any federal programs are reimbursing indirect costs to this grantee/contractor by a measure other than the approved rates in this agreement, the grantee/contractor should credit such costs to the affected programs, and the approved rate should be used to identify the maximum amount of indirect cost allocable to these programs.
- I. Central Service Costs: Where central service costs are estimated for the calculation of indirect cost rates, adjustments will be made to reflect the difference between provisional and final amounts.
- J. Other:
 - 1. The purpose of an indirect cost rate is to facilitate the allocation and billing of indirect costs. Approval of the indirect cost rate does not mean that an organization can recover more than the actual costs of a particular program or activity.
 - 2. Programs received or initiated by the organization subsequent to the negotiation of this agreement are subject to the approved indirect cost rate if the programs receive

administrative support from the indirect cost pool. It should be noted that this could result in an adjustment to a future rate.

3. New indirect cost proposals are necessary to obtain approved indirect cost rates for future fiscal or calendar years. The proposals are due to [name of cognizant federal government agency] six (6) months prior to the beginning of the year to which the proposed rates will apply.

SECTION III: ACCEPTANCE

Listed below are the signatures of acceptance for this agreement:

By the Non-profit Organization

For the Cognizant Federal Government Agency:

(Name of the Organization)

U.S. Environmental Protection Agency

Signature

Signature

Name

Name

Title

Title

Date

Date

Negotiating Agency

Telephone #

APPENDIX F

FREQUENTLY ASKED QUESTIONS

– Adapted from the US Department of Labor, Indirect Cost Rate Determination Guide; may change as EPA policy changes

QUESTIONS AND ANSWERS

Q. What do we do if some grants/contracts do not provide for any indirect costs or provide for indirect cost rates that are lower than those established, provisional or final?

A. Any allocable indirect costs that exceed any administrative or statutory restrictions on a specific federal grant/contract may not be shifted to other federal grants/contracts, unless specifically authorized by legislation. Non-federal revenue sources must be used to pay for these unrecovered costs.

Q. Will EPA assist grantees/contractors in obtaining proper approval of the indirect cost rate from other federal agencies and state and local units of government?

A. EPA will be available to explain to other organizations the methodology used in development of the grantee's/contractor's indirect cost rate. However, the funding of indirect costs is subject to approval of government authorized representatives and contracting officers of the respective organization. Under most circumstances, other federal agencies will recognize and pay a grantee/contractor's approved indirect cost rate. The cognizant federal agency cannot, however, require states or units of local government to recognize an approved indirect cost rate.

Q. Our grant with EPA totals \$500,000 and includes a provisional indirect cost rate of 10%. Our actual, final indirect cost rate is 13%. Will EPA provide us with additional grant funds due to our higher indirect cost rate?

A. EPA will not provide your organization with additional grant funds due to a higher final indirect cost rate than the established provisional rate. However, a grant modification may be allowed to transfer budgeted direct costs to the indirect cost category due to the increased indirect costs. This would be subject to the terms and conditions of the grant agreement, e.g. approval of grant officer, indirect cost ceilings, administrative cost limitations.

Q. In the event that a grantee/contractor under expends the total grant/contract but exceeds the ceiling placed on the indirect cost by EPA, can the excess indirect cost be recovered?

A. No. The ceiling on the indirect cost was included in the agreement to limit the amount of grant/contract funds used for indirect cost purposes by the grantee/contractor. This condition was known by the grantee/contractor before any grant/contract funds were expended.

Q. Can our indirect cost rate proposal be based only on federal funds since it only represents 15% of our total revenue?

A. No. Your indirect cost rate proposal must be accompanied by a schedule of costs

incurred for all projects, federal and non-federal and the amount of the proposed allocation base must tie-in with the applicable direct cost base for all projects.

Q. Is the cost of accrued annual leave allowable under OMB Circular A-122?

A. OMB Circular A-122, Attachment A, Paragraph 2E, states "To be allowable under an award, costs must be determined in accordance with generally accepted accounting principles". The Financial Accounting Standards Board issued Financial Accounting Standard Number 43 "Accounting for Compensated Absences" to establish uniformity in the accounting for annual leave pay. This standard requires employers to accrue during each accounting period the liability for compensated absences earned by employees during that period provided that all of the following conditions are met:

1. The employer's obligation relating to employees' rights to receive compensation for future absences is attributable to employees' services already rendered;
2. The obligation relates to rights that vest or accumulate;
3. Payment of compensation is probable; and
4. The amount can be reasonably estimated.

The accrual of annual leave does not result in increased costs, but allows recognizing the cost in the proper accounting period to improve actual cost determination. In general, compensated absences are to be accrued in the period in which they are earned rather than when they are paid. In order for accrued leave to be an allowable cost, the personnel policies of the organization must comply with the Financial Standard Number 43.

Q. What is the difference between bid and proposal costs and fund raising costs and how does a grantee/contractor treat such costs in its indirect cost proposal?

A. Bid and proposal costs represent the salaries, consultant fees, printing, postage, travel, etc. associated with an organization's preparation of bids, proposals and applications to perform specific tasks for remuneration under potential federal and non-federal grants, contracts or other agreements. An organization should treat bid and proposal expenses as allowable indirect costs subject to any limitations imposed by the cognizant federal agency. Fund raising costs represent the salaries, consultant fees, printing, postage, travel, etc. associated with an organization's requests to private institutions or individuals for donation of funds for non-specific purposes. Fund raising costs are unallowable for federal reimbursement purposes. However, this activity (cost objective) shall be allocated an appropriate share of indirect costs. Accordingly, fund raising costs are to be included in the distribution base used to compute an organization's indirect cost rate.

Q. Can the audit costs under OMB Circular A-133 be recovered?

A. A-133 allows audit costs to be recovered as either direct or indirect costs in accordance with applicable cost principles. However, there is no special appropriation for audit costs. To recover audit costs, the organization must build them into the specific grant/contract documents (if direct) or into the overhead proposal (if indirect).

Q. If the grantee's policy is to capitalize equipment under the \$5,000 threshold specified in A-122, do they need federal approval prior to directly charging the grant with the cost of equipment?

A. No. The grantee is allowed to directly charge the federal grant with the cost of equipment under the \$5,000 threshold without obtaining prior federal approval. This direct cost is usually classified as supplies in the reporting of federal grant expenditures and, if applicable, must be in compliance with any budget limitations.

Q. A grantee has contracted to update its computer network with its affiliates for a total cost of \$50,000. Since each component i.e., monitor, printer, personal computer, software, modem, etc., costs less than the \$5,000 per unit threshold specified in A-122, can this "equipment" be charged to the indirect cost pool?

A. No. The components of the computer network make it useable for the purpose for which it was acquired and therefore establishes the "system" as a capital expenditure. Accordingly, this equipment can be appropriately charged to federal grants either as a direct or indirect cost, on the basis of depreciation or a use allowance as specified in A-122.

Q. A grantee purchased a building in September 1995 and refinanced its mortgage in September 1998. Can the grantee now charge federal programs with the interest incurred on this mortgage?

A. No. Interest on debt incurred to finance or refinance assets acquired before or reacquired after June 1, 1998 is not allowable.

Q. When is a grantee required to prepare a cash flow statement prior to claiming interest expense on federal programs?

A. A cash flow statement is to be prepared on an annual basis for debt arrangements over \$1 million, unless an initial equity contribution to the asset purchase equals 25% or more. A non-profit organization shall reduce claims for interest expense by an amount equal to imputed interest earnings on excess cash flow, which is to be calculated in accordance with Paragraph 23.a. (1)(f)(ii) of Circular A-122.

Q. What is required of a grantee that sells its facilities and decides to rent office space in another facility at less cost to its federal programs?

A. Substantial relocation of federally-sponsored activities from a facility financed by indebtedness, the cost of which was funded in whole or part through federal reimbursements, to another facility prior to the expiration of a period of 20 years, requires notice to the cognizant federal agency for possible adjustment to future space costs charged to federal programs.

Q. What is the relationship of OMB Circular A-122, Cost Principles for Non-Profit Organizations and OMB Circular A-133, Audits of Institutions of Higher Education and Other Non-Profit Institutions in regard to indirect costs?

A. The compliance supplement for OMB Circular A-133 incorporates OMB Circular A-

122. It sets forth the major compliance requirements that should be considered in an

organization-wide audit of non-profit institutions receiving federal assistance. The compliance supplement contains general requirements that shall be considered in all financial and compliance audits. Failure to comply with the general requirements could have a material impact on an organization's financial statements.

One of these general requirements is presented in Appendix VII to OMB Circular A-133, "Allowable Costs/Cost Principles." According to this requirement, the auditor is responsible for auditing direct and indirect costs to determine whether costs claimed are in compliance with OMB Circular A-122

Q. Can transactions with an affiliate affect allowable costs?

A. Yes. A problem may arise in transactions between parent organizations and their affiliates when the parent organization has an equity interest in the affiliate. When an equity interest exists, any profits made by the affiliate improve the equity interest of the parent. If an affiliate sells a good or service to the parent and the selling price includes a profit to the affiliate, the parent's equity interest in the affiliate has been increased. If the parent then includes the purchase price as a direct or indirect charge to a federal award, it has violated the OMB Circular A-122 cost principle that charges will be at cost and not include a profit factor.

For example, suppose your organization (the parent) obtains accounting services from an affiliate and the parent organization has an equity interest in the affiliate. The fee that the parent pays to the affiliate must be based on the cost incurred by the affiliate and the fee may not include a profit to the affiliate. If the fee does include a profit factor to the affiliate, the allowable part of the fee is limited to that portion which represents the cost to the affiliate exclusive of any profit factor.

This principle works in reverse as well. When an organization provides a good or service to an affiliate, the full cost of providing that good or service must be recovered from the affiliate and an appropriate credit must be applied to the indirect cost pool.

Q. What is the period of time that an indirect cost rate agreement covers?

A. A provisional indirect cost rate is negotiated to cover a one-year period. However, because of the time lapse between the submission and approval of a rate, EPA usually establishes provisional rates for a two-year period. A final indirect cost rate agreement is negotiated to cover one fiscal year period after which a new final indirect cost rate must be negotiated for the subsequent fiscal year.

Q. When a grantee/contractor is required by EPA to submit a closeout package prior to negotiating a final indirect cost rate, what is the procedure?

A. The grantee/contractor should prepare the closeout package using the approved provisional indirect cost rate and include a statement indicating that a provisional indirect cost rate was used pending negotiations of a final indirect cost rate. Upon receipt of a final indirect cost rate, an amended final closeout will be submitted.

Q. What can the submitting organizations do to help the cognizant federal agency facilitate their review of an indirect cost rate proposal?

A. If there are any questions concerning any aspect of the proposal, call the cognizant federal agency rate negotiator to resolve the issue prior to formal submission. Also, if during a prior negotiation you agreed to take corrective action(s) on any issues, you must disclose the status of your action(s). Finally, you must inform the cognizant federal agency about all significant organizational or accounting changes and their impact(s). If these actions are taken, it could save time in getting the proposal negotiated.

Q. What are some of the concerns the federal agencies have about grantee/contractor submissions of indirect cost rate proposals?

A. The primary concern of federal agencies is the receipt of incomplete documentation. Indirect cost proposals do not provide sufficient detail to explain the functions and the benefits associated with the costs being allocated. An additional concern to federal agencies is an indirect cost proposal that is not reconcilable to a budget or a financial statement and contains no explanation of the difference.

APPENDIX G

DEFINITIONS

Cognizant Agency means the federal agency responsible for negotiating and approving indirect costs rates for a non-profit organization on behalf of all federal agencies that provide funds to that organization.

Note: To simplify relations between federal grantees and awarding agencies, OMB established the Cognizant Agency concept, under which a single agency represents all others in dealing with grantees in common areas. In this case, the Cognizant Agency reviews and approves grantees' indirect cost rates. Approved rates must be accepted by other agencies, unless specific program regulations restrict the recovery of indirect costs. The cognizant agency for non-profit organizations is determined by calculating which federal agency provides the most grant funding.

Cost Element is a unit of costs, which estimated by a single value or range of values.

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

Direct Costs are costs that can be identified specifically with a particular final cost objective, i.e., a particular award, project, service, or other direct activity of an organization. (A-122, B.1.)

Facilities and Administrative Costs (F & A) are costs that are incurred for common or joint objectives and cannot be readily identified with a particular final cost objective. (A-122, C.1.)

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

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

Indirect Costs are costs that have been incurred for common or joint objectives and cannot be readily identified with a particular final cost objective.

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

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

Note: "An upward adjustment in a 'provisional indirect cost rate' contained in a grant award, which contemplated a possible increase in the indirect costs rate at a later date, does not constitute an additional or new award. Payments resulting from such an adjustment are chargeable to the appropriation originally obligated by the grant." (Excerpt from GAO's Principles of Federal Appropriations Law at 10-71.)

Total Costs of an award is the sum of the allowable direct costs and allocable indirect costs, less applicable credits. (A-122, A.1.)

Unallowable Costs are costs that may not be charged to a federal sponsored activity because it is either expressly disallowed under A-122 or because it is not allocable in accordance with A-122.

APPENDIX H

REFERENCE MATERIALS

- OMB Circular A-122, “Cost Principles for Non-Profit Organizations.”
- 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 Organizations.”
- 40 CFR Part 30 (Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals and Other Nonprofit Organizations)
- 45 CFR Part 74, Appendix E (Principles for Determining Costs Applicable to Research and Development Under Grants and Contracts with Hospitals)
- 48 CFR Part 31 (Federal Acquisition Regulation)
- Internet Sites:
 - a. OMB Circulars - www.whitehouse.gov/omb/grants/index.html
 - b. GASB Statements - www.rutgers.edu/Accounting/raw/gasb/st/summary
 - c. FASB Statements - www.rutgers.edu/Accounting/raw/fasb/st/summary
 - d. CFR Sections - www.access.gpo.gov/nara/cfr/index.html
 - e. Actuarial Standards of Practice - www.actuary.org/standard.htm

APPENDIX I

EPA's ADDRESS

Regular Mail:

Grants Administration Division
Office of Grants and Debarment
U.S. Environmental Protection Agency
1200 Pennsylvania Avenue, NW, MC 3903R
Washington, DC 20460
Attn: Indirect Cost Rate Proposal Control Desk

Mail Courier (e.g. FedEx, UPS, etc.):

Grants Administration Division
Office of Grants and Debarment
U.S. Environmental Protection Agency
1300 Pennsylvania Avenue, NW, 5th floor
Washington, DC 20004
Attn: Indirect Cost Rate Proposal Control Desk