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# Circular A-122: Navigating Cost Principles With Federal Grants

Ascertaining Whether Rent, Personnel and Other Costs Charged to Grants are Allowable

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TUESDAY, NOVEMBER 22, 2011

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

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Today's faculty features:

Anne Worrell Beech, President, A. Worrell Beech Inc., Kensington, Md.

Paul Calabrese, Senior Manager, Rubino & McGeehin, Bethesda, Md.

**For this program, attendees must listen to the audio over the telephone.**

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# Circular A-122: Navigating Cost Principles With Federal Grants Seminar

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Nov. 22, 2011

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# Today's Program

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Direct Cost Principles, Tactics Under Circular A-122  
*[Anne Worrell Beech]*

Slide 7 - Slide 21

Understanding DHHS Indirect Rate Submission Template -  
Format  
*[Paul Calabrese]*

Slide 22 - Slide 24

Dealing With Oversight And Indirect Rate Negotiations  
*[Paul Calabrese]*

Slide 25 - Slide 33

Anne Worrell Beech, A. Worrell Beech Inc.

**DIRECT COST PRINCIPLES,  
TACTICS UNDER CIRCULAR A-  
122**

# Agenda For This Section

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Today we will review:

- General criteria for costs

- Compensation for personal services

- Incentive compensation

- Severance

- Timekeeping

- Fixed assets and depreciation

- Certain “unallowable” costs

# General Criteria

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ALL COSTS MUST BE:

- Allowable
- Allocable
- Reasonable
- Consistently treated

# Compensation For Personal Services

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All compensation paid or accrued, including but not limited to:

- Salaries
- Wages
- Director's and executive committee fees
- Incentive awards (*de minimis* rules - see IRS Pub 15-B)
- Fringe benefits
- Pension plan payments (not administrative costs)
- Incentive pay
- Location and off-site allowances, hardship pay and cost of living differentials

# Compensation For Personal Services (Cont.)

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## Criteria

- Reasonable
- Conforms to established policy of the organization
- Consistently applied (federal and non-federal activities and direct vs. indirect)

## My suggested support:

- Salary surveys
- Written compensation policy, established job titles and descriptions with salary ranges
- For trustee, director's or advisory committee fees: Support for services rendered such as reports, meeting minutes, etc.

# Incentive Compensation

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## Test

- Must be linked to cost reduction, efficiency performance, suggestions or safety awards
- Must be linked to a prior agreement between employee and employer or
- Must be per established plan, consistently applied

## My suggested support:

- Annual performance plans with established metrics
- Quarterly recognition programs with written criteria
- (Note: Review the taxability of your award program; see IRS Pub 15-B and Pub 535, Chap. 2)

# Severance

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## Criteria

Allowable if required by:

- Law
- Employer-employee agreement
- Established policy that constitutes an implied agreement on the organization's part
- Circumstances of the particular employment

# Severance (Cont.)

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## Special provisions

- Can include in rates if “actual normal turnover”; circular contains provisions for accruing a “reserve”
- “Abnormal severance” should be negotiated in advance with cognizant agency
- “Golden parachutes” in excess of normal severance that are contingent on change in management control or ownership are unallowable,
- Severance to foreign nationals in excess of the organization’s U.S. practices, or when a project is ending, are unallowable unless approved by the awarding agency.

## My suggested support:

- Written policies, consistently applied, based on years of service

# Timekeeping

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## Criteria

- The circular uses vague language such as “personnel activity reports.”
- Required for all staff charging to either direct (either for reimbursement or cost-sharing/-matching) or indirect cost objectives
- Must reflect “after-the-fact,” actual activity; i.e., not budget estimates
- Must be “total time”
- Must be signed by employee or supervisor with knowledge of work performed
- Must be monthly or shorter time

# Timekeeping (Cont.)

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My suggested support:

- A standard timekeeping system, on same schedule as payroll
- Employee signs timesheet
- Supervisor reviews and “approves” timesheet
- Written timekeeping policies
- Documentation showing the occasional training of staff on timekeeping policies

# Fixed Assets And Depreciation

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- Need to follow the property management requirements detailed in OMB Circular A-110
- The capitalization policy for financial statement purposes and property management thresholds must be the same - no more than \$5,000.
- Value for each individual item that can stand alone and has a useful life of more than one year
  - Example: Organization's capitalization policy is \$1,000. A desktop computer with a CPU costing \$1,100 and ancillary devices of \$500. Capitalize and track the CPU only. Suggest the A/P entry show the exact detail, so that the G/L will reflect the exact cost on the fixed-asset schedule.

# Fixed Assets And Depreciation (Cont.)

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- Purchase of “direct” equipment must either be in budget or get written approve from agreement officer.
  - If budget has, for example, 10 air conditioners at \$1,000 and later find actual costs is \$500, CANNOT buy 20
- Change in useful lives is an accounting change and must be approved by the cognizant agency.
- Physical inventory must be preformed no less often than every two years.

# Summary Of Certain “Unallowable” Costs

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- Advertising to “sell” to the government, or to solely promote the organization; examples are trade shows, promotional materials and labor related to trade shows. There is a fine line between advertising and public relations; allowable if necessary to “keep the public informed on matters of public concern.”
- Bad debt or other losses on awards or contracts, including cost share and under-recovery of indirect costs. An exception is made for termination costs. Suggest specific expert assistance as soon as government hints at the possibility of a termination.
- Contingency provisions and reserves other than self-insurance, pensions and normal severance pay
- Contributions made by the organization - cash, property and services
- Donated services, goods or space. Note: If donated services are significant, you may need to allocate indirect costs to them.

## Summary Of Certain “Unallowable” Costs (Cont.)

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- Certain legal costs; i.e., those brought by a government entity, matters related to the Major Fraud Act and patent infringement. This is a very complex section of the regulations. Expert opinion should be sought when including anything other than an “ordinary course of business” legal expense in indirect rates.
- Entertainment and social activities - tickets to shows and events, meals, etc. Be careful interpreting the allowable “employee morale” provisions too loosely.
- Fines and penalties from failure to comply with laws and regs, unless allowed in award or in writing from award officer
- Fundraising and investment management costs. Note: Must treat as a cost center and allocate indirect costs consistent with other cost centers

## Summary Of Certain “Unallowable” Costs (Cont.)

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- Any goods or services from personal use, even if reported to IRS as a taxable event
- Idle facilities, including all cost of maintaining the facilities unless due to unforeseen circumstances. Basically, you have a one-year grace period to use, sub-lease or dispose of such facilities.
- Interest: Generally unallowable; see the regs for rare exceptions
- Lobbying: Generally unallowable; see the regs for the very specific exceptions. You must include a certification with the indirect cost proposal stating regs have been followed; documentation must support assertion. Like fundraising activities, treat as cost objective and allocate indirect costs consistent with other cost centers.
- Taxes: Federal income tax or tax for which an exemption is available

Paul Calabrese, Rubino & McGeehin

**UNDERSTANDING DHHS  
INDIRECT RATE SUBMISSION  
TEMPLATE - FORMAT**

# Important Note

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- Much of this section will focus on a sample indirect cost proposal format posted with your materials. You can also print a copy by looking at the “Conference Materials” box on the left-hand side of your computer screen, and looking under the “Handouts” tab for the “Sample Indirect Cost Handout” exhibit.

# Indirect Rate Submission To DHHS

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- DHHS indirect rate template is most widely accepted amount by federal agencies
- Submit it within 90 days of first federal award or 6 months after FYE, if you have existing federal awards
- Should be predicated on post-audit trial balance, most recent FY
- Submission format/schedule is located at [http://rates.psc.gov/fms/dca/np\\_exall.pdf](http://rates.psc.gov/fms/dca/np_exall.pdf)
- Submission checklist is located at <http://rates.psc.gov/fms/dca/icpchecklist.pdf>
- Review guide for non-profit's indirect rate proposals is located at <http://rates.psc.gov/fms/dca/negrev4.pdf>
- Step-by-step review of DHHS indirect rate proposal format follows this slide

Paul Calabrese, Rubino & McGeehin

**DEALING WITH OVERSIGHT  
AND INDIRECT RATE  
NEGOTIATIONS**

# No Indirect Rate System Fits All

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- OMB Circular A-122, Attachment A, Sect. C
- Due to diverse characteristics and accounting practices of non-profits, it is not possible to specify the types of cost which may be classified as indirect in all situations.

# Advance Understandings

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- OMB Circular A-122, Attachment A, Sect. A.6
- Under any award, the allocation of certain expenses may be difficult to determine.
- Purpose is to avoid a subsequent disallowance or dispute.
- Seek a written agreement with cognizant awarding agency in advance of incurrence of cost

# Indirect Cost Allocations

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- OMB Circular A-122, Attachment A, Sect. D.1.e
- Period for allocating and accumulating incurred indirect cost to grants
  - Base period equals the organization's fiscal year.
  - Grants cross over two fiscal years.
    - Two different indirect rates

# Indirect Rate Administration

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- Negotiation and approval of indirect rates per Circular A-122, Attachment A, Sect. E
  - Agency with largest dollar value = Cognizant agency
  - Indirect rate proposal submitted 90 days after new award to an organization
  - May not be necessary if you have program restrictions
    - HRSA Part B, CFDA 93.914 limits adm. to 10%
  - Issues when agency is not proactive in the negotiation, and settlement of indirect rates

# Indirect Rate Administration (Cont.)

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- Negotiation and approval of indirect rates
  - Existing organizations submit new rate proposals within six months after the end of their fiscal year.
  - Pre-determined rate is based on estimate of costs to be incurred for the current or future fiscal year. The predetermined rate is not subject to adjustment.

# Indirect Rate Administration (Cont.)

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- Fixed (ceiling) rates are similar to pre-determined rates, except:
  - The difference between the estimated and actual costs of the period are carried forward as an adjustment to the subsequent period's indirect rate computation.
- Final rate
  - Based on actual cost for period
  - Once negotiated, not subject to adjustment

# Indirect Rate Administration (Cont.)

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- “Provisional” rate
  - Temporary indirect cost rate, pending final rate
  - Used for funding, interim billing or cost reporting
  - If future rate in FY 2011 is substantially higher than historical rate in FY 2010, consider preparing a separate budgeted rate for FY 2011, in order to negotiate the provisional rate in addition to the FY 2010 historical indirect rate proposal.

# Indirect Rate Administration (Cont.)

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- The results of any negotiation is distributed to other participating agencies/
- Many clients complain they cannot find the office for negotiating the indirect rate.
  - Look at conditions clauses attached to grant