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GRANTS AND CONTRACTS WITH CERTAIN NONPROFIT ORGANIZATIONS

Principles for Determining Cost

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Principles for Determining Cost

This notice offers interested parties an opportunity to comment on a proposed Circular concerning principles for determining cost for grants and contracts with certain nonprofit organizations.

The proposed Circular is the product of an interagency study group under the leadership of the Federal Procurement Regulations staff of the General Services Administration. Its purpose is to provide one standard set of cost principles in place of existing principles issued by individual agencies which contain varying or conflicting requirements.

The Office of Management and Budget has, as yet, made no decisions with respect to the proposed principles. All interested parties are encouraged to make their views known. Comments should be submitted in duplicate to the Financial Management Branch, Budget Review Division, Office of Management and Budget, Washington, D.C. 20503. All comments should be received on or before June 15, 1977.

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Assistant to the Director
for Administration.

DRAFT

[Circular No. A...]

MAY , 1977.

To the heads of executive departments and establishments. Subject: Principles for determining cost for grants and contracts with certain nonprofit organizations.

1. *Purpose.*—This Circular provides principles for determining the cost applicable to work performed by nonprofit organizations other than educational institutions, hospitals, and State, local and Indian tribal governments under contracts and grants (including other agreements). The principles are designed to provide that the Federal Government bears its fair share of costs recognized under these principles, except where restricted or prohibited by law. The principles do not attempt to prescribe the percentage of Federal cost sharing or matching on contracts or grants. However, when such percentages are used, they shall be applied to the total cost of the project and arbitrary limitations shall not be placed on individual cost elements by Federal agencies. Any provision for profit or other increment above cost is outside the scope of this Circular.

2. *Application.*—These principles shall be used by all Federal agencies in determining the allowable costs of work performed by nonprofit organizations under grants, cost-reimbursement type contracts, and other contracts in which costs are used in the pricing, administration, or settlement of the contracts. The principles do not apply to construc-

tion, facility improvement, or equipment acquisition awards.

All cost reimbursement subawards, i.e., subgrants, subcontracts, etc., made under a grant or cost-reimbursement type contract and fixed price subawards in which costs are used in the pricing, administration or settlement of the awards are subject to those Federal cost principles appropriate to the subawardee organization and the type of award involved. Thus, if a subgrant or subcontract is with a nonprofit organization other than an educational institution, hospital, or State, local or Indian tribal governmental unit this Circular would apply; if a subcontract is with a commercial organization the commercial Contract Cost Principles and Procedures would apply; if a subgrant or subcontract is with an educational institution the cost principles for Grants and Contracts with Educational Institutions would apply; if a subgrant or subcontract is with a State or local government the cost principles for Grants and Contracts with State and local governments would apply.

3. *Policy.*—The uniform policies and standards included in the Attachments to this Circular replace the varying and sometime conflicting requirements that have been imposed by Federal agencies as conditions of grants and contracts.

The successful application of these principles requires development of mutual understanding between representatives of nonprofit organizations and of the Federal Government as to their scope, implementation, and interpretation. Each organization should be expected to employ sound management practices in the fulfillment of its obligations. Each organization possessing its own unique combination of staff, facilities, and experience should conduct its activities in a manner consonant with its own philosophies and objectives. Costs assigned to contracts and grants must be adequately documented.

4. *Definitions.*—(a) *Grant* means money or property provided in lieu of money paid or furnished by the Federal Government to recipients under programs that provide financial assistance or that provide support or stimulation to accomplish a public purpose. The term "grant" includes the term "other agreements" insofar as the term grant is used in the circular. The term "other agreement" does not include contracts which are required to be entered into and administered under procurement law and regulations. Grants and other agreements exclude (a) technical assistance programs, which provide services instead of money; (b) assistance in the form of general revenue sharing, loans, loan guarantees, or insurance and direct payments of any kind to individuals.

(b) *Non Profit Organization* is any corporation, trust, association, cooperative, or other organization which (1) is operated primarily for scientific, education, service, charitable, or similar pur-

poses in the public interest; (2) is not organized primarily for profit; and (3) uses its net proceeds to maintain, improve, and/or expand its operations. For this purpose, the term "nonprofit organization" excludes (i) educational institutions, (ii) hospitals, and (iii) State, local, and Indian tribal governments, (iv) those nonprofit organizations described in paragraph 5 below.

The charter or other legally binding authority for the existence of the organization must provide that (1) no part of the net earnings, properties, or other assets of the organization, on dissolution or otherwise, shall inure to the benefit of any private person, or individual including any member, employee, director, or trustee of the organization; and (2) on liquidation or dissolution all properties and assets remaining after providing for all debts and obligations shall be distributed and paid over to such other fund, foundation, or other organization formed and operated as a nonprofit organization or institution as the Board of Directors or Trustees may determine. Organizations which have tax exemptions as nonprofit organizations from the U.S. Internal Revenue Service shall be considered to have met the criteria of this definition. For purposes of this subpart, the terms nonprofit and not-for-profit as they are descriptively applied to organizations shall be considered synonymous provided the requirements of (a) and (b) of this paragraph are met.

5. *Exclusion of Some Non Profit Organizations.*—(a) Some nonprofit organizations (other than colleges and universities, State, local and Indian tribal governments, and hospitals) because of their size or scope of operations can be considered to be similar to commercial concerns for purposes of applicability of cost principles. Such nonprofit organizations may propose to operate under the cost principles and procedures applicable to commercial concerns. Whether or not proposed by the organization, the Office of Management and Budget will determine when such a nonprofit organization shall operate under the commercial cost principles. After determination is made that an organization shall operate under commercial cost principles it shall apply to all Government contracts and grants entered into by the organization on or after effective date of applicability to the organization.

(b) Aspects that will be considered before a determination that an organization shall operate under the commercial cost principles are:

(1) The organization proposes that it operate under the Commercial Cost Principles and Procedures;

(2) The organization historically has operated under or has utilized the commercial cost principles for the preponderance of its Government work.

(3) The organization competes to a significant extent for business that often is awarded to commercial concerns; i.e.; the nonprofit organization submits pro-

posals for contracts or applications for grants contending for the same Federal program support.

(4) The organization seeks and is awarded a fee (allowance over allowable costs) in most contract proposals, even though no part of its net earnings inures, or may lawfully inure, to any private shareholder or individual(s).

(5) The organization incurred costs for the performance of Government contracts, subcontracts, or grants in excess of \$5 million in any one of its three preceding fiscal years.

(6) The organization is exclusively or substantially funded by the Federal Government, usually from an agency which has a special continuing or interdependent relationship and the agency considers commercial concern cost principles and procedures to be appropriate.

6. *Policies and Standards.*—The policies and standards promulgated by this Circular are set forth in the Attachments which are: Attachment A Principles for Determining Cost. Attachment B Standards for Selected Items of Cost.

7. *Responsibilities.*—Agencies responsible for administering programs that involve grants and contracts with the nonprofit organizations covered by this Circular shall issue the appropriate instructions necessary to implement the provisions of this Circular. Upon request all instructions implementing this Circular shall be furnished to the Office of Management and Budget. Agencies shall also designate an official to serve as the agency representative on matters relating to the implementation of this Circular. The name and title of such representative shall be furnished to the Office of Management and Budget not later than 1977.

8. *Inquiries.*—Further information concerning this Circular may be obtained by contacting the Financial Management Branch, Budget Review Division, Office of Management and Budget, Washington, D.C. 20503, telephone 395-4773.

9. *Effective Date.*—The principles and standards in the attachments to this Circular will be applied as soon as practicable but not later than six months after the effective date of this Circular.

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ATTACHMENT A—PRINCIPLES FOR DETERMINING COSTS APPLICABLE TO GRANTS AND CONTRACTS WITH OTHER NONPROFIT ORGANIZATIONS

A. Basic Guidelines.

1. General criteria for the allowability of costs.

To be allowable under a contract or grant, costs must meet the following general criteria:

(a) Be necessary and reasonable for the performance of the contract or grant and be allocable thereto under these principles;

(b) Conform to any limitations or exclusions set forth in these principles and procedures, applicable Federal laws, or other governing limitations as to types or amounts of cost items;

(c) Be consistent with policies, regulations, and procedures that apply uniformly to both federally assisted and other activities of the organization;

(d) Be accorded consistent treatment through application of generally accepted accounting principles appropriate to the circumstances; and

(e) Not be allocable to or included as a cost of any other federally financed program in either the current or a prior period.

2. *Reasonable costs.*—A cost is reasonable if, in its nature or amount, it does not exceed that which would be incurred by an ordinarily prudent person under the circumstances prevailing at the time the decision was made to incur the cost. The question of the reasonableness of specific costs must be scrutinized with particular care in connection with organizations or separate divisions thereof which receive the preponderance of their support from contracts or grants awarded by Federal agencies. What is reasonable depends upon a variety of considerations and circumstances involving both the nature and amount of the cost in question. In determining the reasonableness of a given cost, consideration shall be given to:

(a) Whether the cost is of a type generally recognized as ordinary and necessary for the operation of the organization or the performance of the grant/contract;

(b) The restraints or requirements imposed by such factors as generally accepted sound business practices, arms length bargaining, Federal and State laws and regulations, and grant/contract terms and conditions;

(c) 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 Government; and

(d) Significant deviations from the established practices of the organization which may unjustifiably increase the grant/contract costs.

3. *Allocable costs.*—(a) 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 Government grant/contract

if it is treated consistently with other costs incurred for the same purpose in like circumstances and if it:

(1) Is incurred specifically for the grant/contract;

(2) Benefits both the grant/contract and other work and can be distributed to them in reasonable proportion to the benefits received; or

(3) Is necessary to the overall operation of the organization, although a direct relationship to any particular cost objective cannot be shown.

(b) Any cost allocable to a particular grant, contract, or other cost objective under these principles may not be shifted to other Federal grants or contracts to overcome funding deficiencies, or to avoid restrictions imposed by law or by the terms of the contract/grant.

4. *Advance understandings.*—Under any given grant/contract the reasonableness and allocability of certain items of costs may be difficult to determine. This is particularly true in connection with nonprofit organizations which are diverse in nature or which receive a preponderance of their support from grants or contracts awarded by Federal agencies. In order to avoid a possible subsequent disallowance or dispute based on unreasonableness or nonallocability, it is important that organizations entering into grants or contracts with the Government seek agreement in advance of the incurrence of special or unusual costs in categories where reasonableness or allocability are difficult to determine.

5. *Applicable credits.*—(a) The term applicable credits refers to those receipt types or reduction of expenditure types of transactions which operate to offset or reduce expense items that are allocable to grants or contracts as direct or indirect costs. Typical examples of such transactions are: purchase discounts, rebates, or allowances; recoveries or indemnities on losses; sales of scrap or incidental services; and adjustments of overpayments or erroneous charges.

(b) In some instances, the amounts received from the Federal Government to finance organizational activities or service operations should be treated as applicable credits. Specifically, the concept of netting such credit items against related expenditures should be applied by the organization in determining the rates or amounts to be charged to Federal contracts or grants for services rendered whenever the facilities or other resources used in providing such services have been financed directly, in whole or in part, by Federal funds.

B. *Composition of Total Cost.*—The total cost of a contract or grant is the sum of the allowable direct and indirect costs allocable to the grant/contract less any applicable credits.

C. *Direct Cost.*—1. A direct cost is any cost which can be identified specifically with a particular final cost objective; i.e., a particular grant or contract, project, service, or other direct activity of an organization. However, a cost may not be assigned to a grant or contract as a direct cost if any other cost incurred for the same purpose, in like circumstances, has

been allocated to a grant or contract as an indirect cost. Costs identified specifically with the grant or contract are direct costs of the grant or contract and are to be assigned directly thereto. Costs identified specifically with other final cost objectives of the organization are direct costs of those cost objectives and are not to be assigned to the grant/contract directly or indirectly.

2. Any direct cost of a minor dollar amount may be treated as an indirect cost for reasons of practicality where the accounting treatment for such cost is consistently applied to all final cost objectives.

(3) The costs of certain activities are not allowable as charges to Federal grants or contracts (see, for example, fund raising costs in para 21.) However, even though these costs are designated as unallowable for purposes of computing charges to grants and contracts, they nonetheless must be treated as direct costs and be allocated their share of the organization's indirect costs if they represent activities which (1) include the salaries of personnel, (2) occupy space, and (3) benefit from the organization's indirect costs. In addition, the costs of following activities, when normal or necessary to the organization's mission, must also be treated as direct costs and be allocated their share of indirect costs if they meet the criteria stated in the previous sentence:

(a) Maintenance of membership rolls, subscriptions, publications, and related functions;

(b) Providing services and information to members, legislative or administrative bodies, or the public;

(c) Promotion, lobbying, and other forms of public relations;

(d) Meetings and conferences except those held to conduct the general administration of the organization;

(e) Maintenance, protection, and investment of special funds not used in operation of organizations;

(f) Administration of group benefits on behalf of members or clients including life and hospital insurance, annuity or retirement plans, financial aid, etc.

(g) Other activities performed primarily as a service to members, clients, or the public.

D. Indirect costs.—1. Indirect costs are those that have been incurred for common or joint objectives and cannot be readily identified with a particular final cost objective. Any direct cost of minor dollar amount may be treated as an indirect cost under the conditions described in C2. After direct costs have been determined and assigned directly to grants/contracts or other work as appropriate, indirect costs are those remaining to be allocated to benefiting cost objectives. A cost may not be allocated to a grant or contract as an indirect cost if any other cost incurred for the same purpose, in like circumstances, has been assigned to a grant or contract as a direct cost.

2. Because of the diverse characteristics and accounting practices of nonprofit organizations, it is not possible

to specify the types of costs which may be classified as indirect costs in all situations. However, typical examples of indirect costs for many nonprofit organizations may include depreciation or use allowances on buildings and equipment, the costs of operating and maintaining facilities, and general administration and general expenses, such as the salaries and expenses of executive officers, personnel administration, and accounting.

E. Allocation of indirect costs and determination of indirect cost rates

1. **General.**—(a) Where a nonprofit organization has only one major function, or where all its major functions benefit from its indirect costs to approximately the same degree, the allocation of indirect costs and the computation of an indirect cost rate may be accomplished through simplified allocation procedures.

(b) Where an organization has several major functions which benefit from its indirect costs in varying degrees, allocation of indirect costs may require the accumulation of such costs into separate cost groupings which then are allocated individually to benefiting functions by means of a base which best measures the relative degree of benefit. The indirect costs allocated to each function are then distributed to individual grants, contracts, and other activities included in that function by means of an indirect cost rate(s).

(c) The determination of what constitutes an organization's major functions will depend on its purpose in being; the types of services it renders to the public, its clients, and its members; and the amount of effort it devotes to such activities as fund raising, public information and membership activities.

(d) Specific methods for allocating indirect costs and computing direct cost rates along with the conditions under which each method should be used are described below.

(e) The base period for the allocation of indirect costs is the period in which such costs are incurred and accumulated for allocation to work performed in that period. The base period normally should coincide with the organization's fiscal year, but in any event, shall be so selected as to avoid inequities in the allocation of the costs.

2. **Simplified allocation method.**—(a) Where an organization's major functions benefit from its indirect costs to approximately the same degree, the allocation of indirect costs may be accomplished by (1) segregating the organization's total costs for the base period as either direct or indirect, and (2) dividing the total allowable indirect costs (net of applicable credits) by an equitable distribution base. The result of this process is an indirect cost rate which is used to distribute indirect costs to individual grants and contracts. The rate should be expressed as the percentage which the total amount of allowable indirect costs bears to the base selected. This method should also be used where an organization has only one major func-

tion encompassing a number of individual projects or activities, and may be used where the level of Federally supported work at an organization is relatively small.

(b) Both the direct costs and the indirect costs shall exclude capital expenditures and other unallowable costs. However, unallowable costs which represent activities must be included in the direct costs under the conditions described in C3 above.

(c) The distribution base may be total direct costs (excluding capital expenditures and other distorting items, such as major subcontracts or subgrants), direct salaries and wages, or other base which results in an equitable distribution. The distribution base shall also include the value of donated services under the conditions described in item 10, of Attachment B. The distribution base shall generally exclude participant support costs as defined in item 3 of Attachment B.

(d) Except where a special rate(s) is required in accordance with paragraph E5 below, the indirect cost rate developed under the above procedures is applicable to all grants and contracts at the organization. If a special rate(s) is required, appropriate modifications to the procedures shall be made in order to develop the special rate(s).

3. **Multiple allocation base method.**—

(a) Where an organization's indirect costs benefit its major functions in varying degrees, such costs shall be accumulated into separate cost groupings. Each grouping shall then be allocated individually to benefiting functions by means of a base which best measures the relative benefits.

(b) The groupings shall be established so as to permit the allocation of each grouping on the basis of benefits provided to the major functions. Each grouping should constitute a pool of expenses that are of like character in terms of the functions they benefit and in terms of the allocation base which best measures the relative benefits provided to each function. The number of separate groupings should be held within practical limits, after taking into consideration the materiality of the amounts involved and the degree of precision attainable through less precise methods.

(c) Actual conditions must be taken into account in selecting the base to be used in allocating the expenses in each grouping to benefiting functions. When an allocation can be made by assignment of a cost grouping directly to the area benefited, the allocation shall be made in that manner. When the expenses in a grouping are more general in nature, the allocation should be made through the use of a selected base which produces results that are equitable to both the Government and the organization. In general, any cost element or cost related factor associated with the organization's work is potentially adaptable for use as an allocation base provided (1) it can readily be expressed in terms of dollars or other quantitative measures (total direct costs, direct salaries and wages,

man-hours applied, square feet used, hours of usage, number of documents processed, population served, and the like) and (ii) it is common to the benefiting functions during the base period.

(d) Except where a special indirect cost rate(s) is required in accordance with paragraph E5 below, the separate groupings of indirect costs allocated to each major function shall be aggregated and treated as a common pool for that function. The costs in the common pool shall then be distributed to individual grants and contracts included in that function by use of a single indirect cost rate.

(e) The distribution base used in computing the indirect cost rate for each function may be total direct costs (excluding capital expenditures and other distorting items such as major subcontracts and subgrants), direct salaries and wages, or other base which results in an equitable distribution. The distribution base shall also include the value of donated services under the conditions described in item 10 of Attachment B. The distribution base shall generally exclude participant support costs as defined in item 31, Attachment B. An indirect cost rate should be developed for each separate indirect cost pool developed. The rate in each case should be stated as the percentage which the amount of the particular indirect cost pool is of the distribution base identified with that pool.

4. *Direct allocation method.*—(a) Some nonprofit organizations, e.g., voluntary health and welfare organizations, treat all costs as direct costs except general administration and general expenses. These organizations generally segregate their costs into three basic categories: (i) general administration and general expenses, (ii) fund raising, and (iii) other direct functions (including projects performed under grants and contracts). Joint costs, such as depreciation, rental costs, operation and maintenance of facilities, telephone expenses, and the like are prorated individually as direct costs to each category and to each grant, contract, or other activity using a base most appropriate to the particular cost being prorated.

(b) This method is acceptable provided each joint cost is prorated using a base which accurately measures the benefits provided to each grant/contract or other activity. The bases must be established in accordance with reasonable criteria, and supported by current data. This method should be used by organizations that use the Standards of Accounting and Financial Reporting for Voluntary Health and Welfare Organizations.

(c) Under this method, indirect costs consist exclusively of general administration and general expenses. In all other respects, the organization's indirect cost rates shall be computed in the same manner as that described in paragraph E2.

5. *Special indirect cost rates.*—In some instances, a single indirect cost rate for all activities of an organization or for each major function of the organization

may not be appropriate, since it would not take into account those different factors which may substantially affect the indirect costs applicable to a particular segment of work. For this purpose, a particular segment of work may be that performed under a single grant or contract or it may consist of work under a group of grants or contracts performed in a common environment. The factors may include the physical location of the work, the level of administrative support required, the nature of the facilities or other resources employed, the scientific disciplines or technical skills involved, the organizational arrangements used, or any combination thereof. When a particular segment of work is performed in an environment which appears to generate a significantly different level of indirect costs, provisions should be made for a separate indirect cost pool applicable to such work. The separate indirect cost pool should be developed during the course of the regular allocation process, and the separate indirect cost rate resulting therefrom should be used provided it is determined that (1) the rate differs significantly from that which would have been obtained under E2, 3, and 4, and (2) the volume of work to which the rate would apply is material.

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ATTACHMENT B STANDARDS FOR SELECTED ITEMS OF COST

A. *Purpose and Applicability.*—Sections 1 through 51 provide standards to be applied in establishing the allowability of certain items of cost. These standards should apply irrespective of whether a particular item of cost is properly treated as direct cost or indirect cost. Failure to mention a particular item of cost in the standards is not intended to imply that it is either allowable or unallowable; rather determination as to allowability in each case should be based on the treatment or standards provided for similar or related items of cost. In case of a discrepancy between the provisions of a specific grant/contract and the applicable standards provided, the provisions of the grant/contract shall govern.

1. *Advertising costs.*—(a) Advertising costs mean the costs of advertising media and corollary administrative costs. Advertising media include magazines, newspapers, radio and television programs, direct mail, exhibits, and the like.

(b) The only advertising costs allowable are those which are solely for (1) the recruitment of personnel when considered in conjunction with all other recruitment costs, as set forth in para. 41; (2) the procurement of goods and services for the performance of the grant/contract; or (3) the disposal of scrap or surplus materials acquired in the performance of the grant/contract.

(c) Advertising costs other than those specified above are not allowable.

2. *Bad debts.*—Bad debts, including losses (whether actual or estimated) arising from uncollectible accounts and other claims, related collections costs, and related legal costs, are unallowable.

3. *Bid and proposal costs.*—(Reserved.)

4. *Bonding costs.*—(a) Bonding costs arise when the Government requires assurance against financial loss to itself or others by reason of the act or default of the grantee/contractor. They arise also in instances where the grantee/contractor requires similar assurance. Included are such bonds as bid, performance, payment, advance payment, infringement, and fidelity bonds.

(b) Costs of bonding required pursuant to the terms of the grant/contract are allowable.

(c) Costs of bonding required by the grantee/contractor in the general conduct of its operations are allowable to the extent that such bonding is in accordance with sound business practice and the rates and premiums are reasonable under the circumstances.

5. *Compensation for personal services.*—(a) *Definition.*—Compensation for personal services includes all remuneration paid currently or accrued by the organization for services of employees rendered during the period of grant/contract performance (except as otherwise provided in paragraph (h) below). It includes, but is not limited to, salaries, wages, directors' and executive committee members' fees, incentive awards, fringe benefits, pension plan costs, allowances for off-site pay, incentive pay, location allowances, hardship pay, and cost of living differentials.

(b) *Allowability.*—Except as otherwise specifically provided in this paragraph the costs of such remuneration are allowable to the extent that:

(1) Total compensation to individual employees is reasonable for the services rendered and conforms to the established policy of the organization consistently applied to both Government and non-Government activities; and provided that

(2) The charges for work performed directly under Government grants/contracts and for other work allocable as indirect costs under such grants/contracts are determined and supported as hereinafter provided in this paragraph.

(c) *Reasonableness.*—(1) When the organization is predominantly engaged in activities other than those sponsored by the Government, compensation for employees on Government sponsored work will be considered reasonable to the extent that it is consistent with that paid for similar work in the organization's other activities.

(2) When the organization is predominantly engaged in Government activities, and in cases where the kind of employees required for the Government activities are not found in the organization's other activities, compensation for employees on Government work will be considered reasonable to the extent that it is comparable to that paid for similar work in the labor markets in which the organization competes for the kind of employees involved.

(d) *Review and approval of compensation of individual employees.*—In determining the reasonableness of compensation, the compensation of each individual employee normally need not be subject to review and approval. Reviews and approvals of individuals need be made only in those cases in which a general review reveals amounts or types of compensation which appear unreasonable or otherwise out of line.

(e) *Special considerations in determining allowability.*—Certain conditions require special consideration and possible limitation as to allowability for grant and contract cost purposes where amounts appear excessive. Among such conditions are the following:

(1) Compensation to members, trustees, directors, associates, officers, or members of the immediate families thereof. Determination should be made that such compensation is reasonable for the actual personal services rendered rather than a distribution of earnings in excess of costs.

(2) Any change in an organization's compensation policy resulting in a substantial increase in the organization's level of compensation, particularly when it was concurrent with an increase in the ratio of Government awards to other activities of the organization or any change in the treatment of allowability of specific types of compensation due to changes in Government policy.

(3) The organization's activities are such that its compensation levels are not subject to the restraints normally occurring in the conduct of competitive business.

(f) *Unallowable costs.*—Costs which are unallowable under other paragraphs of this Attachment shall not be allowable under this paragraph solely on the basis that they constitute personal compensation.

(g) *Fringe benefits.*—(1) Fringe benefits in the form of regular compensation paid to employees during periods of authorized absences from the job, such as annual 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 see paragraph (h) below), and the like, are allowable provided such benefits are granted in accordance with established organization policies, and provided such contributions and other expenses, whether treated as indirect costs or as an increment of direct labor costs, are distributed to particular grants or contracts 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 grants and contracts and other activities.

(h) *Pension plan costs.*—(1) Costs of the organization's pension plan which are incurred in accordance with the established policies of the organization are allowable, provided:

(i) Such policies meet the test of reasonableness;

(ii) The methods of cost allocation are not discriminatory;

(iii) The amount assigned to each fiscal period is determined in accordance with generally accepted accounting principles as prescribed in Accounting Principles Board Opinion No. 8 issued by the American Institute of Certified Public Accountants; and

(iv) The costs assigned to a given fiscal period are funded within six months after the end of that period.

(2) Pension plan termination insurance premiums paid pursuant to the

Employee Retirement Income Security Act of 1974 (Pub. L. 93-406) are allowable. Late payment charges on such premiums are unallowable.

(3) Excise taxes on accumulated funding deficiencies and prohibited transactions of pension plan fiduciaries imposed under the Employee Retirement Income Security Act are unallowable.

(i) *Incentive compensation.*—Incentive compensation to employees based on cost reduction, or efficient performance, suggestion awards, safety awards, etc., are allowable to the extent that the overall compensation is determined to be reasonable and such costs are paid or accrued pursuant to an agreement entered into in good faith between the organization and the employees before the services were rendered, or pursuant to an established plan followed by the organization so consistently as to imply, in effect, an agreement to make such payment.

(j) *Severance pay.*—See para. 45.

(k) *Training and education expenses.*—See para. 49.

(l) *Support of salaries and wages.*—(1) Charges to grants and contracts for salaries and wages, whether treated as direct costs or allocated as indirect costs, will be based on documented payrolls approved by a responsible official(s) of the organization. The distribution of salaries and wages to grants and contracts must be supported by time or effort distribution reports as prescribed in subparagraph (2) below.

(2) Reports reflecting the distribution of the time or effort of each employee must be maintained for all staff members (professionals and nonprofessionals) whose compensation is charged, in whole or in part, directly to grants or contracts. In addition, in order to support the allocation of indirect costs, such reports must also be maintained for other employees whose effort is expended on two or more functions or activities if a distribution of their compensation between such functions or activities is needed in the determination of the organization's indirect cost rate(s) (e.g., an employee engaged part-time in indirect cost activities and part-time in a direct function). Reports maintained by nonprofit organizations to satisfy these requirements must meet the following standards:

(i) The reports must reflect an after-the-fact determination of the actual time or effort expended by each employee. Budget estimates (i.e., estimates determined before the services are performed) do not qualify as support for charges to grants or contracts.

(ii) Each report must account for the total effort for which the employee is compensated and which is required in fulfillment of his obligations to the organization.

(iii) The reports must include a certification signed by the individual employee, or by a responsible supervisory official having first-hand knowledge of the activities performed by the employee, that the distribution of time or effort represents a reasonable estimate of the

actual work performed by the employee during the periods covered by the reports.

(iv) The reports must be prepared at least monthly and must coincide with one or more pay periods.

(3) Charges for the salaries and wages of nonprofessional employees, in addition to the supporting documentation described in subparagraphs (1) and (2) above, must also be supported by records indicating the total number of hours worked each day maintained in conformance with Department of Labor regulations implementing the Fair Labor Standards Act (29 CFR Part 516). For this purpose, the term "nonprofessional employee" shall have the same meaning as "nonexempt employee," under the Fair Labor Standards Act.

(4) Salaries and wages used in meeting cost sharing or matching requirements on grants and contracts must be supported in the same manner as salaries and wages claimed for reimbursement from sponsoring agencies.

6. *Contingencies.*—Contributions to a contingency reserve or any similar provision made for events the occurrence of which cannot be foretold with certainty as to time, intensity, or with an assurance of their happening, are unallowable.

7. *Contributions.*—Contributions and donations by the organization to others are unallowable.

8. *Depreciation and use allowances.*—
(a) Compensation for the use of buildings, other capital improvements, and equipment on hand may be made through use allowances or depreciation. However, except as provided in paragraph (g) below a combination of the two methods may not be used in connection with a single class of fixed assets (e.g., buildings, office equipment, computer equipment, etc.).

(b) The computation of use allowances or depreciation shall be based on the acquisition cost of the assets involved. The acquisition cost of an asset donated to the organization by a third party shall be its fair market value at the time of the donation.

(c) The computation of use allowances or depreciation will exclude:

(1) The cost of land;
(2) Any portion of the cost of buildings and equipment borne by or donated by the Federal Government irrespective of where title was originally vested or where it presently resides; and

(3) Any portion of the cost of buildings and equipment contributed by or for the organization in satisfaction of any Federal cost sharing or matching requirement subsequent to the effective date of this Circular.

(d) Where the use allowance method is followed, the use allowance for buildings and improvements (including land improvements such as paved parking areas, fences, and sidewalks) will be computed at an annual rate not exceeding two percent of acquisition cost. The use allowance for equipment will be computed at an annual rate not exceeding six and two-thirds percent of acquisition cost.

(e) Where the depreciation method is followed, the period of useful service (useful life) established in each case for usable capital assets must take into consideration such factors as type of construction, nature of the equipment used, technological developments in the particular program area, and the renewal and replacement policies followed for the individual items or classes of assets involved. The method of depreciation used to assign the cost of an asset (or group of assets) to accounting periods shall reflect the pattern of consumption of the asset during its useful life. In the absence of clear evidence indicating that the expected consumption of the asset will be significantly greater in the early portions of its useful life than in the later portions, the straight-line method shall be presumed to be the appropriate method. Depreciation methods once used shall not be changed unless approved in advance by the cognizant Federal agency. When the depreciation method is introduced for application to assets previously subject to a use allowance, the combination of use allowances and depreciation applicable to such assets must not exceed the total acquisition cost of the assets. Gains and losses on the disposition of depreciable property shall be included as credits or charges to appropriate cost groupings in accordance with paragraph 17(b).

(f) When the depreciation method is used for buildings, a building's shell may be segregated from each building component (e.g., plumbing system, heating and air conditioning system, etc.) and each item depreciated over its estimated useful life; or the entire building (i.e., the shell and all components) may be treated as a single asset and depreciated over a single useful life. When the use allowance method is used for buildings, the entire building must be treated as a single asset; the building's components cannot be segregated from the building's shell. The two percent building use allowance limitation must be applied to all parts of the building. The two percent limitation, however, need not be applied to equipment which is merely attached or fastened to the building but not permanently fixed to it and which is used as furnishings or decorations or for specialized purposes (e.g., dentist chairs and dental treatment units, counters, laboratory benches bolted to the floor, dishwashers, carpeting, etc.). Such equipment will be considered as not being permanently fixed to the building if it can be removed without the need for costly or extensive alterations or repairs to the building to make the space usable for other purposes. Equipment that meets these criteria will be subject to the six and two-thirds percent equipment use allowance limitation.

(g) When the depreciation method is used for a particular class of assets, no depreciation may be allowed on any such assets that, under paragraph (e) above, would be viewed as fully depreciated. However, a reasonable use allowance may be negotiated for such assets if war-

ranted after taking into consideration the amount of depreciation previously charged to the Government, the estimated useful life remaining at time of negotiation, the effect of any increased maintenance charges or decreased efficiency due to age, and any other factors pertinent to the utilization of the asset for the purpose contemplated.

(h) Charges for use allowances or depreciation must be supported by adequate property records and periodic inventories must be taken (a statistical sampling basis is acceptable) to ensure that the records are accurate. When the depreciation method is followed, adequate depreciation records indicating the amount of depreciation taken each period must also be maintained.

9. *Donated capital assets.*—See paragraph 8.

10. *Donated services received.*—(a) 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.

(b) 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(s) and, accordingly, shall be allocated a proportionate share of applicable indirect costs when the following circumstances exist:

(1) There is a basis for determining the fair market value of the services rendered;

(2) The aggregate value of the services is material; and

(3) The services are supported by the indirect costs incurred by the organization.

(c) The value of donated services may be used to meet cost sharing or matching requirements under the conditions described in Attachment E, Office of Management and Budget Circular No. A-110 (41 FR 32017, July 30, 1976). Where donated services are treated as indirect costs, indirect cost rates will segregate the value of the donations so that reimbursement will not be made.

(d) Fair market value of donated services shall be computed as follows:

(1) *Rates for volunteer services.*—Rates for volunteers shall be consistent with those regular rates paid for similar work in other activities of the organization. In cases where the kinds of skills involved are not found in the other activities of the organization, the rates used shall be consistent with those paid for similar work in the labor market in which the organization competes for such skills.

(2) *Services donated by other organizations.*—When an employer donates the services of an employee, these services shall be valued at the employee's regular rate of pay (exclusive of fringe benefits and indirect costs) provided the services are in the same skill for which the employee is normally paid. If the services are not in the same skill for

which the employee is normally paid, fair market value shall be computed in accordance with subparagraph (1) above.

11. *Donated goods and space.*—(a) Donated goods; i.e., expendable personal property/supplies, and donated use of space may be furnished to an organization. The value of the goods and space is not reimbursable either as a direct or indirect cost.

(b) The value of the donations may be used to meet cost sharing or matching share requirements under the conditions described in Attachment E, Office of Management and Budget Circular No. A-110 (41 F.R. 32017, July 30, 1976). The value of the donations shall be determined in accordance with Attachment E. Where donations are treated as indirect costs, indirect cost rates will segregate the value of the donations so that reimbursement will not be made.

12. *Employee morale, health, and welfare costs credits.*—The costs of house publications, health or first-aid clinics, and/or infirmaries, recreational activities, employees' counseling services, and other expenses incurred in accordance with the organization's established practice or custom for the improvement of working conditions, employer-employee relations, employee morale, and employee performance, are allowable. Such costs will be equitably apportioned to all activities of the organization. Income generated from any of these activities will be credited to the cost thereof unless such income has been irrevocably set over to employee welfare organizations.

13. *Entertaining costs.*—Costs of amusement, diversion, social activities, ceremonials, and incidental costs relating thereto, such as meals, lodging, rentals, transportation, and gratuities, are unallowable (but see paragraphs 12 and 27).

14. *Equipment and other capital expenditures.*—(a) For purposes of paragraph (b) of this paragraph, the following terms have the meanings set forth below:

(1) "Equipment" means an article of nonexpendable tangible personal property having a useful life of more than one year and an acquisition cost of \$300 or more per unit. An organization may use its own definition provided that it at least includes all nonexpendable tangible personal property as defined herein.

(2) "Acquisition cost" means the net invoice unit price of an item of equipment, including the cost of any modifications, attachments, accessories, or auxiliary apparatus necessary to make it usable for the purpose for which it is acquired. Ancillary charges, such as taxes, duty, protective intransit insurance, freight, and installation shall be included in or excluded from acquisition cost in accordance with the organization's regular accounting practices.

(3) "Special purpose equipment" means equipment which is usable only for research, medical, scientific, or technical activities. Examples of special purpose equipment include microscopes,

x-ray machines, surgical instruments, and spectrometers.

(4) "General purpose equipment" means equipment which is usable for other than research, medical, scientific, or technical activities, whether or not special modifications are needed to make the equipment suitable for a particular purpose. Examples of general purpose equipment include office equipment and furnishings, air conditioning equipment, reproduction and printing equipment, motor vehicles, and automatic data processing equipment.

(b) (1) Capital expenditures for general purpose equipment are unallowable except where such expenditures are specifically approved by the awarding agency as a direct cost.

(2) Capital expenditures for special purpose equipment are allowable as direct costs provided that the acquisition of items with a unit cost of \$1,000 or more is approved by the awarding agency.

(c) Capital expenditures for land or buildings are unallowable except where such costs are specifically approved by the awarding agency as a direct cost.

(d) Capital expenditures for improvements to land, buildings, or equipment which materially increase their value or useful life are unallowable except where such costs are specifically approved by the awarding agency as a direct cost.

(e) Equipment and other capital expenditures are unallowable as indirect costs. However, see paragraph 8 for allowability of use allowances or depreciation on buildings, capital improvements, and equipment. Also, see paragraph 43 for allowability of rental costs for land, buildings, and equipment.

15. *Fines and penalties.*—Costs of fines and penalties resulting from violations of, or failure of the organization to comply with Federal, State, and local laws and regulations are unallowable except when incurred as a result of compliance with specific provisions of the grant or contract or instructions in writing from the sponsoring agency.

16. *Fringe benefits.*—See paragraph 5(g).

17. *Gains and losses on disposition of depreciable property or other capital assets.*—(a) Except with respect to gains and losses from the sale, retirement, or other disposition of depreciable property which is covered in paragraph (b) of this paragraph, gains or losses of any nature arising from the sale or exchange of facilities, equipment, or other capital assets, including sale or exchange of either short or long-term investments, shall be excluded in computing contract or grant costs.

(b) (1) Gains and losses on the sale, retirement, or other disposition of depreciable property shall be included in the year in which they occur as credits or charges to the cost grouping(s) in which the depreciation applicable to such property was included. The amount of the gain or loss to be included as a credit or charge to the appropriate cost grouping(s) shall be the difference between

the amount realized on the property and the undepreciated basis of the property resulting from the depreciation method used in determining depreciation charges to Federal grants and contracts. However, in the case of gains, the amount of the credit shall be limited to the total depreciation included in the cost grouping(s) during the years in which Federal grants and contracts participated in such charges.

(2) Gains and losses on the disposition of depreciable property shall not be recognized as a separate credit or charge under the following conditions:

(i) The gain or loss is processed through a depreciation reserve account and is reflected in the depreciation allowable under paragraph 8.

(ii) The property is given in exchange as part of the purchase price of a similar item and the gain or loss is taken into account in determining the depreciation cost basis of the new item.

(iii) A loss results from the failure to maintain permissible insurance, except as otherwise provided in paragraph 20 (a) (3).

(iv) Compensation for the use of the property was provided through use allowances in lieu of depreciation in accordance with paragraph 8.

(3) Gains and losses arising from mass or extraordinary sales, retirements, or other dispositions shall be considered on a case-by-case basis.

18. *Idle facilities and idle capacity.*—(a) As used in this paragraph the words and phrases defined in this paragraph (a) shall have the meanings set forth below:

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

(2) *Idle facilities* means completely unused facilities that are excess to the organization's current needs.

(3) *Idle capacity* means the unused capacity of partially used facilities. It is the difference between that which a facility could achieve under 100 percent operating time on a one-shift basis less operating interruptions resulting from time lost for repairs, setups, unsatisfactory materials, and other normal delays, and the extent to which the facility was actually used to meet demands during the accounting period. A multiple-shift basis may be used if it can be shown that this amount of usage could normally be expected for the type of facility involved.

(4) Costs of idle facilities or idle capacity are costs such as maintenance, repair, housing, rent, and other related costs; e.g., property taxes, insurance, and depreciation or use allowances.

(b) The costs of idle facilities are unallowable except to the extent that:

(1) They are necessary to meet fluctuations in workload; or

(2) Although not necessary to meet fluctuations in workload, they were necessary when acquired and are now

idle because of changes in program requirements, grantee/contractor efforts to achieve more economical operations, reorganization, termination, or other causes which could not have been reasonably foreseen. Under the exception stated in this subparagraph costs of idle facilities are allowable for a reasonable period of time, ordinarily not to exceed one year, depending upon the initiative taken to use, lease, or dispose of such facilities (but see para. 48 (b) and (e)).

(c) The costs of idle capacity are normal costs of doing business and are a factor in the normal fluctuations of usage or indirect cost rates from period to period. Such costs are allowable, provided the capacity is reasonably anticipated to be necessary or was originally reasonable and is not subject to reduction or elimination by subletting, renting, or sale, in accordance with sound business, economics, or security practices. Widespread idle capacity throughout an entire facility or among a group of assets having substantially the same function may be idle facilities.

19. *Independent research and development.*— [Reserved.]

20. *Insurance and indemnification.*—

(a) Insurance includes insurance which the organization is required to carry, or which is approved, under the terms of the grant or contract and any other insurance which the organization maintains in connection with the general conduct of its operations.

(1) Costs of insurance required or approved, and maintained, pursuant to the grant or contract are allowable.

(2) Costs of other insurance maintained by the organization in connection with the general conduct of its operations are allowable subject to the following limitations.

(i) Types and extent of coverage shall be in accordance with sound business practice and the rates and premiums shall be reasonable under the circumstances.

(ii) Costs allowed for business interruption or other similar insurance shall be limited to exclude coverage of management fees.

(iii) Costs of insurance or of any provisions for a reserve covering the risk of loss of or damage to Government property are allowable only to the extent that the organization is liable for such loss or damage.

(iv) Provisions for a reserve under an approved self-insurance program are allowable to the extent that types of coverage, extent of coverage, and rates and premiums would have been allowed had insurance been purchased to cover the risks, except that provisions for known or reasonably estimated self-insured liabilities, such as liabilities for workmen's compensation, which do not become payable for more than one year after such provision is made, shall not exceed the present value of the liability, determined by using a rate of six percent compounded annually.

(v) Costs of insurance on the lives of trustees, officers, or other employees holding positions of similar responsibilities

are allowable only to the extent that the insurance represents additional compensation (see Paragraph 5). The cost of such insurance when the organization is identified as the beneficiary is unallowable.

(3) Actual losses which could have been covered by permissible insurance (through the purchase of insurance or a self-insurance program) are unallowable unless expressly provided for in the grant or contract, except:

(i) Costs incurred because of losses not covered under nominal deductible insurance coverage provided in keeping with sound business practice, are allowable;

(ii) Minor losses not covered by insurance, such as spoilage, breakage, and disappearance of supplies, which occur in the ordinary course of operations, are allowable; and

(iii) Where an organization follows a consistent policy of expensing actual payments to employees for workmen's compensation or unemployment compensation, such costs will be allowable in the year of payment, provided that these costs are allocated to all activities of the organization.

(b) Indemnification includes securing the organization against liabilities to third persons and any other loss or damage, not compensated by insurance or otherwise. The Government is obligated to indemnify the organization only to the extent expressly provided in (a) (3) above.

21. *Interest, fund raising, and investment management costs.*—(a) Costs incurred for interest on borrowed capital or temporary use of endowment funds, however represented, are unallowable.

(b) Costs of organized fund raising, including financial campaigns, endowment drives, solicitation of gifts and bequests, and similar expenses incurred solely to raise capital or obtain contributions, are unallowable.

(c) Costs of investment counsel and staff and similar expenses incurred solely to enhance income from investments are unallowable.

(d) Fund raising and investment activities shall be allocated an appropriate share of indirect costs under the conditions described in para. C of Attachment A.

22. *Labor relations costs.*—Costs incurred in maintaining satisfactory relations between the organization and its employees, including costs of labor management committees employee publications, and other related activities, are allowable.

23. *Losses on other grants or contracts.*—Any excess of costs over income on any grant or contract is unallowable as a cost of any other grant or contract. This includes, but is not limited to, the organization's contributed portion by reason of cost sharing agreements or any underrecoveries through negotiation of lump sums for, or ceilings on, indirect costs.

24. *Maintenance and repair costs.*—Costs incurred for necessary maintenance, repair, or upkeep of buildings and

equipment (including Government property unless otherwise provided for) which neither add to the permanent value of the property nor appreciably prolong its intended life, but keep it in an efficient operating condition, are allowable. Costs incurred for improvements which add to the permanent value of the buildings and equipment or appreciably prolong their intended life shall be treated as capital expenditures (see para. 14).

25. *Materials and supplies.*—The costs of materials and supplies necessary to carry out the contract or grant are allowable. Such costs should be charged at their actual prices after deducting all cash discounts, trade discounts, rebates, and allowances received by the organization. Withdrawals from general stores or stockrooms should be charged at cost under any recognized method of pricing consistently applied. Incoming transportation charges may be a proper part of material cost. Materials and supplies charged as a direct cost should include only the materials and supplies actually used for the performance of the contract or grant, and due credit should be given for any excess materials or supplies retained, or returned to vendors.

26. *Meetings, conferences, and conventions.*—(a) Costs associated with the conduct of meetings, conferences, and conventions include the cost of renting facilities, meals, speaker's fees, and the like. But see para. 13, Entertainment Costs and para. 31, Participant support costs.

(b) To the extent that these costs are identifiable with a particular cost objective they should be charged to the objective to which they relate. See para. C of Attachment A. These costs are unallowable as a direct cost of grants and contracts unless approved by the awarding agency.

(c) Costs of meetings and conferences held to conduct the general administration of the organization are allowable.

27. *Memberships, subscriptions, and professional activity costs.*—(a) Costs of the organization's membership in civic, business, technical, and professional organizations are allowable.

(b) Costs of the organization's subscriptions to civic business, professional, and technical periodicals are allowable.

(c) Costs of employee attendance at meetings and conferences, when the primary purpose is the dissemination of technical information, are allowable. This includes costs of meals, transportation, and other items incidental to such attendance.

28. *Organization costs.*—Expenditures, such as incorporation fees, broker's fees, fees to promoters, organizers or management consultants, for attorneys, accountants, or investment counselors, whether or not employees of the organization, in connection with (a) establishment or reorganization of an organization or (b) raising capital, are unallowable unless specified otherwise in the grant or contract.

29. *Overtime, extra-pay shift, and multishift premiums.*— Premiums for

overtime, extra-pay shifts, and multi-shift work are allowable only to the extent approved by the awarding agency except:

(a) When necessary to cope with emergencies, such as those resulting from accidents, natural disasters, breakdowns of equipment, or occasional operational bottlenecks of a sporadic nature;

(b) When employees are performing indirect functions such as administration, maintenance, or accounting;

(c) In the performance of tests, laboratory procedures, or other similar operations which are continuous in nature and cannot reasonably be interrupted or otherwise completed; or

(d) When lower overall cost to the Government will result.

30. *Page charges in scientific journals.*—Page charges for scientific journal publication are allowable as a necessary part of research costs, where:

(a) The research papers report work supported by the Government;

(b) The charges are levied impartially on all research papers published by the journal, whether by non-Government or by Government authors; and

(c) The journals involved are not operated for profit.

31. *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 when approved by the awarding agency.

32. *Patents and copyright costs.*—(a) Costs of (1) preparing disclosures, reports, and other documents required by the grant or contract and of searching the art to the extent necessary to make such disclosures, (2) preparing documents and any other patent costs in connection with the filing and prosecution of a United States patent application where title or royalty-free license is required by Government grant or contract to be conveyed to the Government, and (3) general counseling services relating to patent and copyright matters, such as advice on patent and copyright laws, regulations, clauses, and employee agreements; are allowable (but see para. 35).

(b) Costs of preparing disclosures, reports, and other documents and of searching the art to the extent necessary to make disclosures, if not required by the grant or contract, are unallowable. Costs in connection with (1) filing and prosecuting any foreign patent application, or (2) any United States patent application with respect to which the grant or contract does not require conveying title or a royalty-free license to the Government, are unallowable (also see para. 44).

33. *Pension plans.*—See para. 5(h).

34. *Preaward costs.*—Preaward costs are those incurred prior to the effective date of the grant or contract directly

pursuant to the negotiation and in anticipation of the award of the grant or contract where such incurrence is necessary to comply with the proposed delivery schedule or period of performance. Such costs are allowable only to the extent that they would have been allowable if incurred after the date of the award and only with the written approval of the awarding agency.

5. *Professional and consultant service costs—legal, accounting, scientific, and other.*—(a) Costs of professional and consultant services rendered by persons who are members of a particular profession or possess a special skill, and who are not officers or employees of the organization, are allowable, subject to (b), (c), and (d) of this para. when reasonable in relation to the services rendered and when not contingent upon recovery of the costs from the Government.

(b) In determining the allowability of costs in a particular case, no single factor or any special combination of factors is necessarily determinative. However, the following factors among others may be relevant:

(1) The nature and scope of the service rendered in relation to the service required;

(2) The necessity of contracting for the service, considering the organization's capability in the particular area;

(3) The past pattern of such costs, particularly in the years prior to the award of Government contracts, and grants.

(4) The impact of Government contracts and grants on the organizations business (i.e., what new problems have arisen);

(5) Whether the proportion of Government work to the organizations total business is such as to influence the organization in favor of incurring the cost, particularly where the services rendered are not of a continuing nature and have little relationship to work under Government contracts and grants;

(6) Whether the service can be performed more economically by employment rather than contracting;

(7) The qualifications of the individual or concern rendering the service and the customary fees charged, especially on non-Government contracts and grants; and

(8) Adequacy of the contractual agreement for the service (e.g., description of the service, estimate of time required rate of compensation, and termination provisions).

(c) In addition to the factors in paragraph (b) of this paragraph retainer fees to be allowable must be supported by evidence of bona fide services available or rendered.

(d) Cost of legal, accounting, and consulting services, and related costs, incurred in connection with organization and reorganization, defense of antitrust suits, and the prosecution of claims against the Government, are unallowable. Costs of legal, accounting and consulting services, and related costs, incurred in connection with patent in-

fringement litigation, are unallowable unless otherwise provided for in the contract or grant.

36. *Protection and security costs.*—Necessary expenses incurred to comply with Government security requirements or for facilities protection, including wages, uniforms, and equipment of personnel, are allowable.

37. *Public information services costs.*—(a) Public information services costs include the cost associated with pamphlets, news releases, and other forms of information services. Such costs are normally incurred to:

(1) Inform or instruct individuals, groups, or the general public;

(2) Interest individuals or groups in participating in a service program of the organization;

(3) Provide stewardship reports to State and local government agencies, benefactor foundations, and associations, etc.; and

(4) Disseminate the results of sponsored and nonsponsored activities.

(b) If the costs incurred for any of these purposes are identifiable with a particular cost objective, they shall be charged to the objective to which they relate.

(c) Costs that are not identifiable with a particular cost objective shall be allocated as indirect costs to all benefiting activities of the organization.

(d) Public information services costs are unallowable as a direct cost of grants and contracts unless approved by the awarding agency.

38. *Publication and printing costs.*—(a) Publication costs include the costs of printing (including the processes of composition, plate-making, press work, binding, and the end products produced by such processes), distribution, promotion, mailing, and general handling.

(b) If these costs are not identifiable with a particular cost objective they should be allocated as indirect costs to all major activities of the organization.

(c) Publication and printing costs are unallowable as a direct cost of grants and contracts unless the publication and printing is required by the grant or contract or is approved by the awarding agency.

(d) The costs of page charges in scientific journals is addressed in para. 30.

39. *Rearrangement and alteration costs.*—Costs incurred for ordinary or normal rearrangement and alteration of facilities are allowable. Special arrangement and alteration costs incurred specifically for the project are allowable when such work has been approved in advance by the sponsoring agency concerned.

40. *Reconversion costs.*—Costs incurred in the restoration or rehabilitation of the organization's facilities to approximately the same condition existing immediately prior to commencement of Government contract or grant work, fair wear and tear excepted, are allowable.

41. *Recruitment costs.*—Provided that the size of the staff recruited and

maintained is in keeping with workload requirements, costs of "help wanted" advertising, operating costs of an employment office necessary to secure and maintain an adequate labor force, costs of operating an educational testing program, travel costs of employees while engaged in recruiting personnel, and travel costs of applicants for interviews for prospective employment, and relocation costs incurred incident to recruitment of new employees (but see paragraph 42(c)) are allowable. Where the organization uses employment agencies, costs not in excess of standard commercial rates for such services are allowable.

42. *Relocation costs.*—(a) Relocation costs are costs incident to the permanent change of duty assignment (for an indefinite period or for a stated period of not less than 12 months) of an existing employee or upon recruitment of a new employee.

Relocation costs are allowable subject to the limitations described in paragraphs (b), (c), and (d) below provided that:

(1) The move is for the benefit of the employer;

(2) Reimbursement to the employee is in accordance with an established policy or practice consistently followed by the employer; and

(3) The reimbursement does not exceed the employee's actual (or reasonably estimated) expenses.

(b) Allowable relocation costs for existing employees are limited to the following costs:

(1) The costs of transportation of the employee, members of his immediate family, and his household and personal effects to the new location.

(2) The costs of finding a new home, such as advance trips by employees and spouses to locate living quarters and temporary lodging during the transition period, up to a maximum period of 30 days, including advance trip time.

(3) Closing costs, such as brokerage, legal, and appraisal fees, incident to the disposition of the employee's former home. These costs together with those described in (4) of this paragraph (b) are limited to 8 percent of the sales price of the employee's former home.

(4) The continuing costs of ownership of the vacant former home after the settlement or lease date of the employee's new permanent home, such as maintenance of buildings and grounds (exclusive of fixing up expenses), utilities, taxes, and property insurance.

(5) Other necessary and reasonable expenses normally incident to relocation, such as the costs of cancelling and unexpired lease, disconnecting and re-installing household appliances, and purchasing insurance against damages to personal property. The cost of cancelling an unexpired lease is limited to three times the monthly rental.

(c) Allowable relocation costs for new employees are limited to those described in (1) and (2) of paragraph (b) above. When relocation costs incurred incident

to the recruitment of new employees have been allowed either as a direct or indirect cost and the employee resigns for reasons within his control within 12 months after hire, the organization shall refund or credit such relocation costs to the Government. However, the costs of travel to an overseas location shall be considered travel costs in accordance with paragraph 51 and not relocation costs for the purpose of this paragraph if dependents are not permitted at the location for any reason and the costs do not include costs of transporting household goods.

(d) The following costs related to relocation are unallowable:

(1) Fees and other costs associated with acquiring a new home;

(2) A loss on the sale of a former home;

(3) Continuing mortgage principal and interest payments on a home being sold; and

(4) Income taxes paid by an employee related to reimbursed relocation costs.

43. *Rental costs.*—(a) Subject to the limitations described in paragraphs (b) through (d) of this paragraph, rental costs are allowable to the extent that the rates are reasonable in light of such factors as rental costs of comparable property, if any; market conditions in the area; alternatives available; and the type, life expectancy, condition, and value of the property leased.

(b) Rental costs under sale and lease-back arrangements are allowable only up to the amount that would be allowed had the organization retained legal title to 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. For this purpose, a less-than-arms-length lease is one under which one party to the lease agreement is able to control or substantially influence the actions of the other. Such leases include those between (1) divisions of an organization, (2) organizations under common control through common officers, directors, or members, and (3) an organization and a director, trustee, officer, or key employee of the organization or his immediate family either directly or through corporations, trusts, or similar arrangements in which they hold a controlling interest.

(d) Rental costs under leases which create a material equity in the leased property are allowable only up to the amount that would be allowed had the organization purchased the property on the date the lease agreement was executed. For this purpose, a material equity in the property exists if the lease is noncancelable or is cancelable only upon the occurrence of some remote contingency and has one or more of the following characteristics:

(1) The organization has the right, during or at the expiration of the lease, to purchase the property at a price which at the inception of the lease appears to be substantially less than the probable fair market value at the time it is

permitted to purchase the property (commonly called a lease with a bargain purchase option);

(2) Title to the property passes to the organization at some time during or after the lease period;

(3) The term of the lease corresponds substantially to the estimated useful life of the property; i.e., the period of economic usefulness to the legal owner of the property;

(4) The initial term is less than the useful life of the property and the organization has the option to renew the lease for the remaining useful life at substantially less than fair rental value; or

(5) The property was acquired by the lessor to meet the special needs of the organization and will probably be usable only for that purpose and only by the organization.

44. *Royalties and other costs for use of patents and copyrights.*—(a) Royalties on a patent or copyright or amortization of the cost of acquiring by purchase a copyright, patent, or rights thereto, necessary for the proper performance of the grant or contract are allowable unless:

(1) The Government has a license or the right to free use of the patent or copyright;

(2) The patent or copyright has been adjudicated to be invalid, or has been administratively determined to be invalid;

(3) The patent or copyright is considered to be unenforceable; or

(4) The patent or copyright is expired.

(b) Special care should be exercised in determining reasonableness where the royalties may have been arrived at as a result of less than arm's length bargaining; e.g.:

(1) Royalties paid to persons, including corporations, affiliated with the organization;

(2) Royalties paid to unaffiliated parties, including corporations, under an agreement entered into in contemplation that a Government grant or contract would be awarded; or

(3) Royalties paid under an agreement entered into after the award of a grant or contract.

(c) In any case involving a patent or copyright formerly owned by the organization, the amount of royalty allowed should not exceed the cost which would have been allowed had the organization retained title thereto.

45. *Severance pay.*—(a) Severance pay also commonly referred to as dismissal wages, is a payment in addition to regular salaries and wages, by organizations to workers whose employment is being terminated. Costs of severance pay are allowable only to the extent that in each case, it is required by (1) law, (2) employer-employee agreement, (3) established policy that constitutes, in effect, an implied agreement on the organization's part, or (4) circumstances of the particular employment.

(b) Costs of severance payments are divided into two categories as follows:

(1) Actual normal turnover severance payments shall be allocated to all work performed in the organization's facilities; or, where the organization provides for a reserve for normal severances such method will be acceptable if the charge to current operations is reasonable in light of payments actually made for normal severances over a representative past period, and if amounts charged are allocated to all work performed in the organization's facilities; and

(2) Abnormal or mass severance pay is of such a conjectural nature that measurement of costs by means of an accrual will not achieve equity to both parties. Thus accruals for this purpose are not allowable. However, the Government recognizes its obligation to participate to the extent of its fair share, in any specific payment. Thus, allowability will be considered on a case-by-case basis in the event of occurrence.

46. *Specialized service facilities.*—(a) The costs of services provided by highly complex or specialized facilities operated by the organization, such as automated data processing facilities, animal resource centers, and wind tunnels, are allowable provided the charges for the services meet the conditions of either paragraph (b) or (c) of this paragraph, and, in addition, take into account any items of income or Federal financing that qualify as applicable credits under para. 5.

(b) The costs of such services when material in amount must be charged directly to applicable grants and contracts based on actual usage of the services on the basis of a schedule of rates or established methodology that (1) does not discriminate between federally and non-federally supported activities of the organization, including usage by the organization for internal purposes, and (2) is designed to recover only the aggregate costs of the services. The costs of each service shall consist of both its direct costs and its allocable share of all indirect costs. Advance agreements pursuant to paragraph 7 are particularly important in this situation.

(c) Where the costs incurred for a service are not material they may be allocated as indirect costs.

47. *Taxes.*—(a) In general, taxes which the organization is required to pay and which are paid or accrued in accordance with generally accepted accounting principles, and payments made to local governments in lieu of taxes which are commensurate with the local government services received are allowable, except for (1) taxes from which exemptions are available to the organization directly or which are available to the organization based on an exemption afforded the Government and in the latter case when the sponsoring agency makes available the necessary exemption certificates, (2) special assessments on land which represent capital improvements, and (3) Federal income taxes.

(b) Any refund of taxes, interest, or penalties, and any payment to the organization of interest thereon, attributable to taxes, interest, or penalties which

were allowed as grant or contract costs, will be credited or paid to the Government in the manner directed by the Government. However, any interest actually paid or accredited to an organization incident to a refund of tax, interest, and penalty will be paid or credited to the Government only to the extent that such interest accrued over the period during which the organization had been reimbursed by the Government for the taxes, interest, and penalties.

48. *Termination costs.*—Grant and contract terminations generally give rise to the incurrence of costs, of the need for special treatment of costs, which would not have arisen had the grant or contract not been terminated. Cost principles covering these items are set forth below. They are to be used in conjunction with the other provisions of this subpart in termination situations.

(a) Common items. The cost of items reasonably usable on the organization's other work shall not be allowable unless the organization submits evidence that it would not retain such items at cost without sustaining a loss. In deciding whether such items are reasonably usable on other work of the organization, the awarding agency should consider the organization's plans and orders for current and scheduled activity. Contemporaneous purchases of common items by the organization shall be regarded as evidence that such items are reasonably usable on the organization's other work. Any acceptance of common items as allocable to the terminated portion of the grant/contract should be limited to the extent that the quantities of such items on hand, in transit, and on order are in excess of the reasonable quantitative requirements of other work.

(b) Costs continuing after termination. If in a particular case, despite all reasonable efforts by the organization certain costs cannot be discontinued immediately after the effective date of termination, such costs are generally allowable within the limitations set forth in this subpart, except that any such costs continuing after termination due to the negligent or willful failure of the organization to discontinue such costs shall be considered unallowable.

(c) Loss of useful value. Loss of useful value of special tooling and special machinery and equipment is generally allowable if:

(1) Such special tooling, machinery, or equipment is not reasonably capable of use in the other work of the organization;

(2) The interest of the Government is protected by transfer of title or by other means deemed appropriate by the awarding agency; and

(3) The loss of useful value as to any one terminated grant or contract is limited to that portion of the acquisition cost which bears the same ratio to the total acquisition cost as the terminated portion of the grant/contract bears to the entire terminated grant/contract and other Government grants/contracts for which the special tooling and special machinery and equipment was acquired.

(d) *Rental costs.* Rental costs under unexpired leases are generally allowable where clearly shown to have been reasonably necessary for the performance of the terminated grant/contract less the residual value of such leases, if (1) the amount of such rental claimed does not exceed the reasonable use value of the property leased for the period of the grant/contract and such further period as may be reasonable and (2) the organization makes all reasonable efforts to terminate, assign, settle, or otherwise reduce the cost of such lease. There also may be included the cost of alterations of such leased property, provided such alterations were necessary for the performance of the grant/contract, and of reasonable restoration required by the provisions of the lease.

(e) *Settlement expenses.* Settlement expenses including the following are generally allowable:

(1) Accounting, legal, clerical, and similar costs reasonably necessary for:

(i) The preparation and presentation to awarding agency of settlement claims and supporting data with respect to the terminated portion of the grant or contract, unless the termination is by default of the organization (see § 1-8.604 (b) (1) or paragraph 4a of Attachment L, OMB Circular No. A-110 (41 F.R. 32030, July 30, 1976); and

(ii) The termination and settlement of subcontracts and subgrants;

(2) Reasonable costs for the storage, transportation, protection, and disposition of property provided by the Government or acquired or produced for the grant or contract; and

(3) Indirect costs related to salaries and wages incurred as settlement expenses in subparagraphs (1) and (2) of this paragraph; normally, such indirect costs shall be limited to fringe benefits, occupancy cost, and immediate supervision.

(f) Subcontractor and subgrantee claims. Subcontractor/subgrantee claims, including the allocable portion of claims which are common to the grant or contract and to other work of the organization are generally allowable. An appropriate share of the organization's indirect expense may be allocated to the amount of settlements with subcontractors/subgrantees; provided, that the amount allocated is otherwise consistent with the basic guidelines contained in Attachment A. The indirect expense so allocated shall exclude the same and similar costs claimed directly or indirectly as settlement expenses.

4. *Training and educational costs.*—

(a) Costs of preparation and maintenance of a program of instruction at noncollege level, including but not limited to on-the-job, classroom, and apprenticeship training, designed to increase the vocational effectiveness of employees, including training materials, textbooks, salaries or wages of trainees (excluding overtime compensation which might arise therefrom), and (1) salaries of the director of training and staff when the training program is conducted by the organization; or (2) tuition and fees

when the training is in an institution not operated by the organization; are allowable.

(b) Costs of part-time education, at an undergraduate or postgraduate college level, including that provided at the organization's own facilities, are allowable only when the course or degree pursued is relative to the field in which the employee is now working or may reasonably be expected to work, and are limited to:

- (1) Training materials;
- (2) Textbooks;
- (3) Fees charged by the educational institution;

(4) Tuition charged by the educational institution, or in lieu of tuition, instructors' salaries and the related share of indirect costs of the educational institution to the extent that the sum thereof is not in excess of the tuition which would have been paid to the participating educational institution;

(5) Salaries and related costs of instructors who are employees of the organization; and

(6) Straight-time compensation of each employee for time spent attending classes during working hours not in excess of 156 hours per year and only to the extent that circumstances do not permit the operation of classes or attendance at classes after regular working hours; otherwise such compensation is unallowable.

(c) Costs of tuition, fees, training materials, and textbooks (but not subsistence, salary, or any other emoluments) in connection with full-time education, including that provided at the organization's own facilities, at a postgraduate (but not undergraduate) college level, are allowable only when the course or degree pursued is related to the field in which the employee is now working or may reasonably be expected to work, and are limited to a total period not to exceed one school year for each employee so trained. In unusual cases the period may be extended (see paragraph 7).

(d) Costs of attendance of up to 16 weeks per employee per year at specialized programs specifically designed to enhance the effectiveness of executives or managers or to prepare employees for

such positions are allowable. Such costs include enrollment fees, training materials, textbooks and related charges, employee's salaries, subsistence, and travel. Costs allowable under this paragraph do not include those for courses that are part of a degree-oriented curriculum, which are allowable only to the extent set forth in paragraphs (b) and (c) of this paragraph.

(e) Maintenance expense, and normal depreciation or fair rental, on facilities owned or leased by the organization for training purposes are allowable to the extent set forth in paragraphs 24, 8, and 43, respectively.

(f) Grants to educational or training institutions, including the donation of facilities or other properties, scholarships, or fellowships, are considered contributions and are unallowable.

(g) Training and education costs in excess of those otherwise allowable under paragraphs (b) and (c) of this paragraph may be allowed to the extent set forth in an advance agreement. To be considered for an advance agreement, the organization must demonstrate that such costs are consistently incurred pursuant to an established training and education program, and that the course or degree pursued is relative to the field in which the employee is now working or may reasonably be expected to work.

50. *Transportation costs.* Transportation costs include freight, express, cartage, and postage charges relating either to goods purchased, in process, or delivered. These costs are allowable. When such costs can readily be identified with the items involved, they may be directly costed as transportation costs or added to the cost of such items (see paragraph 25). Where identification with the materials received cannot readily be made, transportation costs may be charged to the appropriate indirect cost accounts if the organization follows a consistent, equitable procedure in this respect.

51. *Travel costs.*—(a) Travel costs are the expenses for transportation, lodging, subsistence, and related items incurred by employees who are in travel status on official business of the organization. Travel costs are allowable subject to paragraphs (b) through (f) of this para-

graph, when they are directly attributable to specific work under a grant or contract or are incurred in the normal course of administration of the organization.

(b) Such costs may be charged on an actual basis, on a per diem or mileage basis in lieu of actual costs incurred, or on a combination of the two, provided the method used is applied to an entire trip and not to selected days of the trip, and results in charges consistent with those normally allowed by the organization in its regular operations.

(c) The difference in cost between first-class air accommodations and less than first-class air accommodations is unallowable except when less than first-class air accommodations are not reasonably available to meet necessary mission requirements, such as where less than first-class accommodations would (1) require circuitous routing, (2) require travel during unreasonable hours, (3) greatly increase the duration of the flight, (4) result in additional costs which would offset the transportation savings, or (5) offer accommodations which are not reasonably adequate for the medical needs of the traveler.

(d) Necessary, reasonable costs of family movements and personnel movements of a special or mass nature are allowable, pursuant to paragraphs 41 and 42 subject to allocation on the basis of work or time period benefited when appropriate. Advance agreements are particularly important.

(e) Foreign travel costs are allowable only when the travel has received specific prior approval. Each separate foreign trip must be specifically approved. For purposes of this provision, foreign travel is defined as "any travel outside of Canada and the United States and its territories and possessions."

(f) When an amount for domestic travel is specified in the grant or contract, expenditures for such travel will not be allowed if they exceed the amount specified by more than 25 percent or \$500, whichever is greater, except with approval of the sponsoring agency.

(Sec. 205(c), 63 Stat. 390; 40 U.S.C. 486(c).)

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