

U.S DEPARTMENT OF ENERGY
WEATHERIZATION PROGRAM

FINANCIAL MANAGEMENT TRAINING

Funded by the U.S. Department of Energy
Office of Weatherization and Intergovernmental
Programs

DE-AP26-00NT00902

Developed By:

ACKCO, Inc.
1326 N. Central Avenue, Suite 208
Phoenix, AZ 85004
602-253-9211
800-525-2859

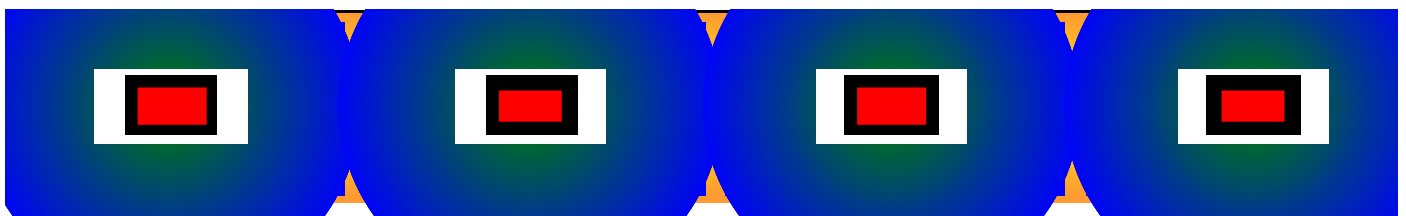




TABLE OF CONTENTS

CHAPTER 1: Introduction.....	1
CHAPTER 2: Financial Assistance Regulations.....	4
DOE Financial Assistance Rules, 10 CFR 600	4
Summary of Applicable Sections	5
Pre-Award Requirements	
1. Grant Application	6
2. Special Restrictive Conditions of Award.....	6
Post-Award Requirements – Financial Administration	
3. Financial Management Standards.....	7
4. Payment.....	9
5. Allowable Costs.....	9
6. Period of Availability of Funds	10
7. Cost Sharing	10
8. Program Income	11
9. Non-Federal Audit.....	11
Changes, Property, and Subawards	
10. Budget and Project Revisions.....	12
11. Real Property and Equipment	13
12. Supplies.....	16
Procurement Standards	
13. Procurement	16
14. Subgrants.....	19
Reports, Records Retention, and Enforcement	
15. Performance Reports	19
16. Financial Reporting	19
17. Record Retention.....	20
After the Grant Requirement	
18. Closeout	20



TABLE OF CONTENTS

CHAPTER 3: Cost Principles	22
1. Basic Guidelines for Costs	22
2. Cost Allocation Plan	22
3. Indirect Cost.....	33
4. Allowability of Selected Cost	40
CHAPTER 4: Budgeting and Financial Planning	46
A. Introduction.....	46
B. Types of Budgets	47
C. Method of Budgeting.....	49
D. Management.....	52
E. Cost Category	53
F. Summary.....	55
APPENDICES: Located on CD Rom	
▪ Sample Financial Procedures	
▪ Sample Procurement Procedures	
▪ Self Assessment Tool	
▪ CFR 600.100 Subpart	
▪ CFR 600.200 Subpart	

CHAPTER ONE INTRODUCTION

Finance can be defined as the art and science of managing money. Virtually all individuals and organizations earn or raise money and spend or invest money. Finance is concerned with the processes, institutions, markets and instruments involved in transfers of money between and among individuals, businesses and governments.

For those who work with federal funds, a thorough understanding of federal financial regulations will facilitate sound financial decision-making. All organizations benefit when they have knowledgeable, well-trained staff performing the day-to-day operations of the finance department. Such staff will make better financial decisions when they are trained to see the total picture, including the regulatory requirements. In financial administration, “it’s not just *how* we do the job, but also *why*” that is important.

The success of an organization often is measured by its accomplishment of goals. Successfully managing the financial resources of an organization maximizes the amount of funds available to accomplish its goals. Thus organizational success and sound financial management are interdependent elements of organizational effectiveness.

A total financial management system is comprised of three major elements or functions:

- First is the budget process. Budgeting is the allocation of fiscal resources to activities that will accomplish program goals within a fiscal year or one-year project period.
- Second is the accounting process. The purpose of accounting is to identify and report all revenues and expenditures that occur during a fiscal year and report this information timely to all interested parties.
- Third is the auditing process. An audit is an external examination of a year’s activities to ensure compliance with all applicable regulations regarding how money is expended and to determine whether proper controls were in operation to safeguard financial resources.

Each of these three areas is a science in itself. The purpose of this training is to focus mainly on the regulations that govern the use of federal funds.

The finance department is responsible for the accounting process—the identification of all monies received and expended during the organization’s fiscal year. These receipts and expenditures are compared to the budget and reported to administrators and department directors so that they can monitor progress and make corrective decisions about the delivery of services to meet organizational and departmental goals. The monthly revenue and expenditure reports must be accurate and timely in order to provide decision-makers with the information they need. Likewise, granting agencies

also require financial reports to evaluate progress in achieving the expected outcomes of grants. Therefore, one of the most important outcomes of good financial management is the provision of accurate and timely information for decision-making. In fact, this is a critical function of financial management.

A knowledgeable and effective finance department will take every opportunity to benefit its organization financially. Since financial administration is the science of managing money, many concepts apply to all organizations as the bases for sound financial management. During this training, we will touch upon concepts such as:

- *cash flow management*,
- *investing* (which maximizes the return on unused cash), and
- *competitive bidding* (which maximizes the return on cash used to purchase desired services/products by identifying the lowest prices available).

Accountability for fiscal resources is a critical concern for all organizations. Both private and public organizations have audits and develop internal controls (also known as “checks and balances”) to protect their money. All assets—whether cash, materials, or fixed or movable assets—must be accounted for and protected. The auditing process includes evaluating internal controls, as well as summarizing the financial activities and stating the financial position of the organization. The auditor’s opinion also includes *findings*, or irregularities, the auditor noted during the audit. The information contained in the audit report is critically important to the organization’s strategic partners, such as granting agencies, banking and other financial institutions, and potential funders.

While there are many similarities between the private and public sectors, there also are some unique differences. One major difference exists when a government agency provides grant funds and/or administers them. Granting agencies are strategic partners with organizations. They assist organizations in providing services that usually could not be provided without grant assistance. However, part of the grant agreement requires the recipient organization to agree to comply with terms and conditions imposed by the granting agency in order to meet its own goals and objectives and to protect government assets. Therefore, both the granting agency and the grant recipient must work cooperatively to accomplish their respective goals. In addition, the grant recipient must be able and willing to meet the financial reporting requirements established by the granting agency.

Accounting for grants not only includes fiscal management but also includes the concept of *indirect cost*, a process by which a grant pays the recipient organization for expenses incurred to administer the grant. Indirect cost reimbursement will be discussed during this training.

Proper financial management increases the success of every organization. While financial management may focus on “number crunching,” its overall outcome is better service to members of targeted communities.

The next three chapters of this training manual include:

- 10 CFR 600—the Financial Assistance Regulations of the Department of Energy.
- OMB Cost Principles—the Office of Management and Budget (OMB) principles for determining the allowable costs of programs under grants, contracts, and cooperative agreements with the Federal Government.
- Weatherization Program Budgeting for Department of Energy grants.

CHAPTER TWO

FINANCIAL ASSISTANCE REGULATIONS

The Department of Energy financial assistance regulations are contained in Title 10 of the Code of Federal Regulations (10 CFR). The 10 CFR details the program and financial regulations that must be followed when administering a program funded by the Department of Energy. Part 440 of 10 CFR (10 CFR 440) contains the program regulations for weatherization, and Part 600 (10 CFR 600) contains the financial assistance regulations. A thorough understanding of both sets of regulations is essential to proper administration of a weatherization program.

■ **DOE FINANCIAL ASSISTANCE RULES, 10 CFR 600**

The DOE Financial Assistance Rules, 10 CFR 600, establish uniform policies and procedures for the award and administration of DOE grants and subgrants. The five major subparts (and the OMB Circulars on which the DOE rules are based) are as follows:

- o Subpart A - General

- o Subpart B - Grants to Other Than State and Local Governments

- o Subpart C - Grants to State and Local Governments

- o Subpart D - Cooperative Agreements

- o Subpart E - Audits

The following section-by-section comparison of 10 CFR 600 as it applies to non-profit organizations versus state/local organizations provides an index of the topics to be covered in this training manual.

SECTION	10 CFR 600 (Non-Profits)	10 CFR 600 (State/Local)
General Requirements	101-104	200-205
Pre-Award Requirements	110-117	210-212
Financial Administration/Management	120-128	220-226
Property Standards	130-137	230-235
Procurement Standards	140-148	236
Reports and Records	150-153	240-242
Termination & Enforcement	160-162	243-244
After-the-Award	170-173	250-252

▪ **SUMMARY OF APPLICABLE SECTIONS:**

This is a summary only. Should a question arise, refer to the complete 10 CFR 600, and review the regulation in its entirety.

■ **PRE-AWARD REQUIREMENTS**

1. GRANT APPLICATION

RULES

State and Local Governments	10 CFR 600.210
Non-Profit Organizations	10 CFR 600.110-112

COMMON REQUIREMENTS

This section prescribes the forms and instructions to be used in applying for federal financial assistance.

Applicants are not required to submit more than the original and two copies of pre-applications and applications.

For amendments (or modifications) to a previously submitted application, only the affected pages shall be submitted.

SIGNIFICANT DIFFERENCES: None

2. SPECIAL RESTRICTIVE CONDITIONS OF AWARDS

RULES

State and Local Governments	10 CFR 600.212
Non-Profit Organizations	10 CFR 600.114

COMMON REQUIREMENTS:

This section defines the circumstances under which a grantee or sub-grantee will be considered high-risk:

- history of unsatisfactory performance,
- financial instability,
- financial management system that does not meet the standards of generally accepted accounting principles,
- noncompliance with requirements in prior awards, or
- other negative indicators.

The granting agency will provide a written explanation of required conditions and corrective actions.

■ **POST-AWARD REQUIREMENTS - FINANCIAL ADMINISTRATION**

3. FINANCIAL MANAGEMENT STANDARDS

RULES

State and Local Governments	10 CFR 600.220
Non-Profit Organizations	10 CFR 600.121

COMMON REQUIREMENTS:

Financial management systems must meet the following minimum standards:

- Provide for accurate, current, and complete disclosure of all financial activities.
- Maintain records that identify the sources and applications of funds.
- Maintain effective control and accountability for all grant-supported cash, property, and other assets.
- Compare actual expenditures with budgeted amounts on a periodic basis.
- Determine allowable costs by OMB cost principles, program regulations, and grant agreement.
- Have accounting records supported by source documents.
- Have procedures to minimize the time elapsing between the transfer of funds from the U.S. Treasury and disbursement of those funds by the grantee or sub-grantee.

SIGNIFICANT DIFFERENCES:

- A. 10 CFR 600.220 states that a granting agency may review the adequacy of the financial management system as part of a pre-award review.
- B. 10 CFR 600.121 states that the federal government may require specific insurance/bonding if certain conditions exist.

**PARTICIPANT ACTIVITY ONE
FINANCIAL MANAGEMENT STANDARDS AND SOURCE DOCUMENTATION**

A. LIST FIVE OF THE SEVEN FINANCIAL MANAGEMENT STANDARDS

1. _____
2. _____
3. _____
4. _____
5. _____

The accountant for the Idaho Community Action Agency had to leave suddenly for six weeks and you are the new Executive Director. Would you sign the checks for the following expenses or would you need additional information.

EXPENSE	SOURCE DOCUMENTATION	APPROVAL TO ISSUE CHECK (If no, what additional information would you need)
Payroll	Timesheet	
Materials	Purchase Order and Invoice	
Travel	Expense Report	
Office Rent	Monthly Bill	
Supplies	Invoice	
Health Insurance	Monthly Invoice	
Professional Services (furnace work)	Monthly Invoice	
Repairs to the Truck	Purchase Order and Invoice	
Printing of Energy Conservation Brochure	Documentation of printer being selected through competitive procurement, work order, purchase order, and invoice	

4. PAYMENT

RULES

State and Local Governments	10 CFR 600.221
Non-Profit Organizations	10 CFR 600.122

COMMON REQUIREMENTS:

All methods and procedures for payment shall minimize the time elapsing between the transfer of funds and disbursement by the grantee or sub-grantee.

The methods that can be used are:

- Advances (for grantees and sub-grantees if they meet established standards.)
- Reimbursements (when requirements for advances are not met or for construction contracts.)
- Working capital advances (if a grantee or sub-grantee cannot meet the criteria for advance payments.)

Recipients also must expend program income, refunds, and audit recoveries before requesting additional federal cash payments.

Payments cannot be withheld unless:

- Recipient has failed to comply with grant award conditions.
- Recipient is indebted to the United States.

Recipients are encouraged to use minority-owned banks.

SIGNIFICANT DIFFERENCES:

- A. 10 CFR 600.221 states that the use of a separate bank account can be required through Federal-State agreement.
- B. 10 CFR 600.221 states that grantee/sub-grantee may keep up to \$100 interest for administrative expenses.
- C. 10 CRF 600.122 states that recipients shall maintain advances in interest bearing accounts unless the recipient receives less than \$120,000 in federal awards per year, the interest is not expected to exceed \$250, and/or the depository requires an unattainable average or minimum balance.

5. ALLOWABLE COSTS

RULES

State and Local Governments	10 CFR 600.222
Non-Profit Organizations	10 CFR 600.127

COMMON REQUIREMENTS:

The allowable costs referenced in 10 CFR 600 are detailed in separate OMB Circulars:

- OMB Circular A-87 - Cost Principles for State and Local Governments.
- OMB Circular A-122 - Cost Principles for Non-Profit Organizations.

SIGNIFICANT DIFFERENCES:

A. The cost principles for non-profit organizations do not address cost allocation plans.

B. The cost principles do not address the exact same costs.

The OMB Cost Principles will be covered in greater detail in the next chapter.

6. PERIOD OF AVAILABILITY OF FUNDS

RULES

State and Local Governments	10 CFR 600.223
Non-Profit Organizations	10 CR 600.128

COMMON REQUIREMENTS:

When a funding period is specified, a grantee may charge to the grant only those costs that result from obligations during the specified funding period.

SIGNIFICANT DIFFERENCES:

- A. 10 CFR 600.223 addresses the period for liquidation of obligations and carryover of unobligated balances.
- B. 10 CFR 600.128 addresses the allowability of pre-award costs with funding source approval.

7. COST SHARING

RULES

State and Local Governments	10 CFR 600.224
Non-Profit Organizations	10 CFR 600.123

COMMON REQUIREMENTS:

All contributions, including cash and in-kind, shall be accepted as part of the recipient's cost sharing or matching if they:

- are verifiable through records,
- are not also counted (i.e., duplicated) as contributions for other federal programs,
- are necessary for the completion of the project,
- are allowable under the cost principles,
- are not paid by other federal funds (unless specifically approved by statute),
- are included in the budget approved by the funding agency, and
- conform to other provisions of the OMB financial management circulars.

SIGNIFICANT DIFFERENCES: None

8. PROGRAM INCOME

RULES

State and Local Governments	10 CFR 600.225
Non-Profit Organizations	10 CFR 600.124

COMMON REQUIREMENTS:

Program income is gross income generated by a grant-supported activity; it is earned only as a result of the grant agreement during the grant period.

The methods for treatment of program income include:

- Addition to grant support
- Deduction from grant support
- Cost Sharing

Unless authorized by Federal regulations or the grant agreement, program income will be treated as gross program income and deducted from the total allowable costs chargeable to the grant.

Unless otherwise stated in the regulations or grant agreement, there are no Federal requirements governing the disposition of program income earned after the award period ends.

SIGNIFICANT DIFFERENCES: None

9. NON-FEDERAL AUDIT

RULES:

State and Local Governments	10 CFR 600.226
Non-Profit Organizations	10 CFR 600.126

COMMON REQUIREMENTS:

State and local governments will be subject to the audit requirements in OMB A-133: Audits of State and Local Governments.

Non-Profit organizations will be subject to the audit requirements in OMB A-133: Audits of Non-Profit Organization.

SIGNIFICANT DIFFERENCES:

A. 10 CFR 600.226 defines specific responsibilities for audits of sub-grantees.

■ **CHANGES, PROPERTY, AND SUBAWARDS**

10. BUDGET AND PROJECT REVISIONS

RULES:

State and Local Governments	10 CFR 600.225
Non-Profit Organizations	10 CFR 600.125

COMMON REQUIREMENTS:

Recipients are permitted to rebudget within the approved direct cost budget to meet unanticipated requirements and make very limited program changes.

The applicable cost principles, which require prior approval, shall apply.

Prior approval is required based on specific clauses within the grant agreement and in the following instances where:

- A revision would result in the need for additional funds;
- Cumulative transfers would exceed 10% of the total budget if the grant is more than \$100,000;
- Funds allotted for training were transferred;
- There is a revision in the program/project objectives or scope of work;
- There is a need to extend the grant period beyond the established end date;
- There is a change in key persons who are central to the purpose of the project;
- Funds are to be transferred from direct costs to indirect costs, or vice versa.

Requests for prior approval will be in the same format as used in the application. The approval must be in writing.

SIGNIFICANT DIFFERENCES:

- A. 10 CFR 600.125 requires prior approval if the project director or principal investigator will be absent for more than three months.
- B. 10 CFR 600.125 requires prior approval if work originally proposed for performance by the grant recipient is to be subcontracted or otherwise transferred to another party.

11. REAL PROPERTY AND EQUIPMENT

RULES:

State and Local Governments	10 CFR 600.231 and .232
Non-Profit Organizations	10 CFR 130-136

COMMON REQUIREMENTS:

Real property means land and structures.

Title to real property will vest with the grantee or sub-grantee.

The awarding agency will provide instructions for disposition of real property when it no longer is needed.

Equipment is defined as tangible, nonexpendable personal property having a useful life of more than one year and an acquisition cost of \$5,000 or more per unit.

Title to equipment acquired under a grant or subgrant will vest with the grant or recipient unless otherwise specified in the terms and conditions of the grant.

Equipment shall be used in the program or project for which it was acquired. The equipment also may be used for other federally supported projects if it does not interfere with the performance of the project for which it originally was acquired.

If replacement equipment is needed, the equipment to be replaced may be used as a trade-in.

The property management requirements include the following:

- Property records that include a description, serial number, source, title, cost, acquisition date, percent of Federal participation, location, use, condition, and ultimate disposition.
- A physical inventory taken at least once every two years.
- A control system to ensure safeguards against loss, damage, or theft.

- Adequate maintenance procedures.
- Proper sales procedures. Items with a fair market value (FMV) of \$5,000 or less that no longer are needed for the grant-funded project can be disposed of with no further obligations. Disposition of items with a FMV of more than \$5,000 requires that the granting agency must receive its fair share.

Federally owned equipment requires a recipient to submit an annual inventory listing. When the equipment no longer is needed, a grantee or sub-grantee will request disposition instructions from the Federal agency.

SIGNIFICANT DIFFERENCES:

- A. 10 CFR 600.232 provides for states to follow state law for management of equipment.

**PARTICIPANT ACTIVITY TWO
EQUIPMENT**

LIST THE ELEVEN ITEMS THAT MUST BE INCLUDED IN THE EQUIPMENT RECORDS

- 1. _____
- 2. _____
- 3. _____
- 4. _____
- 5. _____
- 6. _____
- 7. _____
- 8. _____
- 9. _____
- 10. _____
- 11. _____

12. SUPPLIES

RULES:

State and Local Governments	10 CFR 600.233
Non-Profit Organizations	10 CFR 600.135

COMMON REQUIREMENTS:

Title to supplies acquired under an award will vest with the recipient.

If there is a residual inventory of unused supplies exceeding \$5,000 in total FMV upon termination or completion of the award—and if the supplies are not needed for any other federally sponsored programs—the recipient shall compensate the granting agency for its share of the FMV.

SIGNIFICANT DIFFERENCES:

- A. 10 CFR 600.135 states that the recipient shall not use supplies acquired with Federal funds to provide services to non-Federal outside companies or individuals for a fee that is less than private companies would charge unless approved by the granting agencies.

■ PROCUREMENT STANDARDS

13. PROCUREMENT

RULES:

State and Local Governments	10 CFR 600.236
Non-Profit Organizations	10 CFR 600.140-148

COMMON REQUIREMENTS:

Grantees must meet the following standards:

- There must be a contract administration system.
- There must be a *written* code of conduct governing the grantee's and/or sub-grantee's employees.
- There must be procedures to avoid the purchase of unnecessary or duplicative items.
- Grantees are encouraged to enter into State and local inter-governmental agreements for purchases of common goods and services.

- Grantees are encouraged to use Federal excess and surplus property.
- Procedures to ensure awards are made only to responsible contractors.
- Records that detail the significant history of procurements.
- Grantees must settle all contractual and administrative issues arising out of procurements.
- Grantees will have procedures for protests of procurement awards.

All procurement transactions will be conducted in a manner providing full and open competition based upon written selection and award procedures. Also, the solicitation must include a clear and accurate description of the service or material being procured. The approved methods of procurement are:

- Small purchase procedures for services and goods that will not cost more than \$25,000 in the aggregate.
- Sealed bids (these require formal advertising).
- Competitive proposals.
- Non-competitive proposals may be used *only* when the item is available from a single (sole) source, in emergency situations, when the awarding agency so authorizes, or when competition is determined to be inadequate. Pre-award review may be required for purchases valued at more than \$25,000.

Grantees are to give preference to minority- and woman-owned enterprises, as well as firms in labor surplus areas.

There must be a cost or price analysis in connection with every procurement action.

Upon request by the granting agency, grantees must make available the technical specifications for proposed procurements.

The bonding requirements of a grant recipient will be accepted if the awarding agency's interest is adequately protected. Otherwise, specific requirements described in 10 CFR 600 must be met.

SIGNIFICANT DIFFERENCES:

- A. 10 CFR 600.236 allows States to follow the same policies and procedures it uses for procurement using non-Federal funds.

**PARTICIPANT ACTIVITY THREE
PROCUREMENT**

A. LIST THE NINE PROCUREMENT STANDARDS

1. _____
2. _____
3. _____
4. _____
5. _____
6. _____
7. _____
8. _____
9. _____

B. WHAT ARE THE THREE METHODS OF LARGE PROCUREMENT

1. _____
2. _____
3. _____

C. WHAT ARE THE NINE ITEMS THAT SHOULD BE INCLUDED IN A PROCUREMENT FILE? (A bidders conference was held)

1. _____
2. _____
3. _____
4. _____
5. _____
6. _____
7. _____
8. _____
9. _____

14. SUBGRANTS

RULES:	State and Local Governments	10 CFR 600.237
	Non-Profit Organizations	10 CFR 600.104

SIGNIFICANT DIFFERENCES:

- A. 10 CFR 600 requires States to follow State laws and procedures when awarding and administering subawards to local governments. However, the State must impose the provisions of 10 CFR 600 Subpart B on subawards to nonprofit organizations.

■ REPORTS, RECORDS RETENTION, AND ENFORCEMENT

15. PERFORMANCE REPORTS

RULES:

State and Local Governments	10 CFR 600.240
Non-Profit Organizations	10 CFR 600.15

COMMON REQUIREMENTS:

Performance reports shall not be required more frequently than quarterly or less frequently than annually.

Performance reports shall include periodic reports on progress in meeting program objectives. These progress reports must include comparisons of actual accomplishments to planned objectives.

Quarterly and semi-annual reports will be due 30 days after the reporting period. Annual and final reports will be due 90 days after the grant expiration date.

SIGNIFICANT DIFFERENCES: None.

16. FINANCIAL REPORTING

RULES:

State and Local Governments	10 CFR 600.241
Non-Profit Organizations	10 CFR 600.152

COMMON REQUIREMENTS:

As required in the terms and conditions of the grant award, reports will be submitted on one or more of the following forms:

- SF 269 or SF 269A - Financial Status Report
- SF 270 - Request for Advance or Reimbursement
- SF 272 - Federal Cash Transaction Report

Financial reports will not be required more often than quarterly. They must be submitted within 30 days after the reporting period or, for a final report, within 90 days.

SIGNIFICANT DIFFERENCES: None.

17. RECORDS RETENTION

RULES:

State and Local Governments	10 CFR 600.242
Non-Profit Organizations	10 CFR 600.153

COMMON REQUIREMENTS:

Grantees and sub-grantees must retain records for three years after submitting the final expenditure report.

Records must be maintained until completion of action on all litigation, claims, negotiations, or audits. For property and equipment, the retention period starts upon disposition of the property/equipment.

SIGNIFICANT DIFFERENCES: None

▪ **AFTER THE GRANT REQUIREMENT**

18. CLOSE-OUT

RULES:

State and Local Governments	10 CFR 600.250
Non-Profit Organizations	10 CFR 600.171

COMMON REQUIREMENTS:

The Federal agency will require the following final reports to close out a grant:

- Standard Form 269 - Financial Status Report
- Standard Form 270 - Request for Advance or Reimbursement, if applicable
- Final performance or progress report

The recipient will submit an invention disclosure, if applicable.

The recipient will submit a Federally-owned property report.

Cost and cash adjustments will be made as appropriate.

SIGNIFICANT DIFFERENCES: None

CHAPTER THREE

COST PRINCIPLES

10 CFR 600 requires grant recipients to follow the OMB cost principles contained in OMB A-87 for Governments and OMB A-122 for non-profit organizations, which set forth the principles for determining the allowable costs of programs under grants, contracts, and cooperative agreements with the federal government.

The cost principles address four major areas:

- Basic Guidelines for Costs
- Cost Allocation Plan
- Indirect Costs
- Allowability of selected costs

1. BASIC GUIDELINES FOR COSTS

- Costs are allowable if they are necessary and reasonable, not prohibited under state or local laws, conform to laws and regulations, given consistent treatment, comply with generally accepted accounting principles, and are not included as a cost under other federal programs.
- Allocations of costs must be in proportion to the benefits received, cannot be shifted to overcome deficiencies in other programs, and must be supported by a cost allocation plan.
- Applicable credits are to be used to reduce expenditures to be charged to a given grant.
- The total cost of a grant program is comprised of the allowable direct costs and allowable indirect costs, less applicable credits.

2. COST ALLOCATION PLAN

Cost allocation plans are addressed in OMB A-87; and, although not specifically addressed, the same basic concept is discussed under direct costing of indirect costs in OMB A-122.

Costs incurred by an organization in connection with programs are eligible charges against grants and contracts, whether incurred by the program itself or another program that provided supportive services, as long as the costs are necessary for the efficient performance of the grant or contract.

The cost principles are the federal regulations which must be followed to insure that federally assisted programs incur costs in a manner that enables each program to pay its fair share of costs recognized under these principles, except where restricted by law.

Depending on the specific requirements of each funding source, costs can be shared within the same funding source as well as between funding sources.

o **Allocation of Costs**

- Identify each of the shared costs that should be allocated.
- Identify each of the shared costs that will be included as part of the indirect cost pool, if applicable.
- Determine the method by which costs will be allocated so that each program is paying for its proportionate share of the benefits derived from the costs.
- Prepare the cost allocation plan and submit for internal approval.

o **Cost Allocation Plan**

Definition

A cost allocation plan documents the methods and procedures used to identify, accumulate, and distribute allowable costs in a consistent and equitable manner among activity centers providing services to support a grant or contract. The designated representative or Board of Directors of the recipient organization should approve the cost allocation plan. All costs allocated by the plan must be supported by formal accounting records that substantiate their propriety. The cost allocation plan links the accounting records and the reported expenses of the recipient organization.

The cost allocation plan should contain, but not necessarily be limited to, the following:

- The nature and extent of the activities provided and their relevance to the contract- or grant-supported services.
- A list of the expense items to be charged to the contract or grant.
- The methods to be used in distributing the costs.

Regulations

The requirement to develop and maintain an updated Cost Allocation Plan is based on 10 CFR 600, which refers the grantee to OMB A-87 for governmental and OMB A-122 for non-profits.

Development of Cost Allocation Plan

The complexity or simplicity of a cost allocation plan depends on the type, size, and number of programs and activities of the organization. The purpose of the following section is to emphasize the need and requirement for grantees and sub-grantees to establish and/or maintain logical, reasonable and supportable method(s) of allocating costs to their various functions and activities.

The scope of this section is limited due to the various methods of allocating costs, i.e., total direct costs, direct salaries, person-hours, square feet, hours usage, documents processed, number of clients served, etc. This section applies to all service providers and grantees entering into agreements with the Department.

The application of cost principles is based on the fundamental premises that:

- Organizations are responsible for the efficient and effective administration of grant and contract programs through the application of sound management practices.
- Each organization assumes the responsibility for seeing that federally assisted program funds have been expended and accounted for consistent with underlying agreements and program objectives.
- Each grantee or contractor, in recognition of its own unique combination of staff, facilities and experience, has the primary responsibility for implementing all essential management procedures and techniques to assure proper and efficient administration.

Steps In Preparing a Cost Allocation Plan

- Identify the type and cost of each service to be allocated within the plan.
- Determine the method (unit) for allocating the costs of each service to user programs.
- Allocate costs mathematically to user programs (i.e., calculate proportionate shares of costs).

The most difficult problem of accounting for costs by function occurs when costs benefit more than one function. Salaries, office rent and travel expenses are costs that may be allocable to multiple functions. Organizations are required to develop techniques that will provide measurable bases upon which costs may be linked to services and/or activities. Many costs, for example, logically may be related to time spent on particular functions (e.g., salaries and travel expenses). Others vary with the space used for a particular service or activity (e.g., building depreciation, office rent, and utilities). If space-related costs are to be distributed among services conducted in a particular building, it will be necessary to determine the proportion (amount and percentage) of space used for each service and/or activity. This determination often is based on the amount/percentage of floor space occupied by each service or activity.

Distribution of costs based on employee's time commitments requires time analysis and detailed time reporting, as will be discussed. Other bases for distribution of costs may be established through studies (e.g., of space used for different functions) that result in a standard basis for distributing related costs among functions. Organizations experiencing relatively frequent changes in their activities and staff must recognize changes that are sufficiently important to prompt re-examination of established cost-distribution bases and adjustment of a cost allocation plan. At a minimum, the cost allocation plan should be updated annually.

Because the area of cost allocation is complex and often difficult to explain to members of the organization or representatives of the funding source, it is essential to retain worksheets and other documentation (e.g., multiple-source employee timesheets) used to develop and support your plan.

Considerations

Staff salaries, payroll taxes and related benefits

Since personal services constitute the largest single cost of most organizations, accounting for staff members' time spent in support of particular program services is essential for functional cost reporting. For employees whose time is spent exclusively on one program service, no time reporting problem exists; the cost of their salaries, related payroll taxes and fringe benefits may be charged directly to the particular service.

When staff serve multiple functions or programs during an accounting period, proper allocation of their compensation among those functions or programs requires the accumulation of reliable data documenting their specific time commitments. In some instances, the activities of employees vary considerably from month to month and throughout the year; and, therefore, only their daily time sheets support a reasonable allocation of costs among functions or programs. However, accumulation of detailed daily time reports is a time-consuming task and is not required for all employees, particularly administrative personnel. In some cases, time sampling of the actual data is sufficient to determine a fair basis for time allocations. The determination and use of a sample distribution requires great care. The periods selected for sampling must be both sufficiently random and of sufficient duration to be statistically representative of an employee's total activities for the reporting year. In most cases, this will require that sampling procedures be established on a continuing basis.

Whether time reports are kept on a continuous basis or a system of sampling is used, the results of the actual time reports will be evaluated for reasonableness. Employees must be thoroughly trained in timekeeping and reporting procedures, including the appropriate functional classification of each of their normal tasks. In addition, provisions should be made for continual monitoring of the time reporting procedures to detect and correct errors. A time-based cost allocation plan follows.

Percentage Allocated Costs

STAFF	TOTAL SALARY	Area Agency on Aging	DOE	Area Agency on Aging	DOE
Outreach Worker	21,000	80.0%	20.0%	16,800	4,200
Secretary	14,000	50.0%	50.0%	7,000	7,000
Bus Driver	16,000	100.0%	0.0%	16,000	0
Bookkeeper	19,000	33.3%	66.7%	6,327	12,673
TOTALS	\$70,000			\$46,327	\$23,673

Rent, Utilities, Building Maintenance and Related Expenses

These types of costs are generally related to the square footage occupied by each section of your program. An analysis might appear as follows:

Program Area	Square Feet	Percentage
Administration	1,500	6.8
Area Agency on Aging	18,000	81.4
DOE	2,600	11.8
Total	22,100	100.0

These percentages would then be used to distribute costs related to space occupancy (e.g., building depreciation, rent, and utilities).

The administration portion of occupancy related expenses might not be directly allocable to a given program or objective. If this is the case, these costs could be allocated as indirect costs using a more equitable basis (units of service provided).

Supplies

The basis for allocating some supplies (e.g. raw food, educational materials, general office supplies) is readily identifiable. The basis for allocating others, such as housekeeping supplies, postage or printed materials, may vary depending on the service type or other organization-specific circumstances.

Telephone

Each staff member should keep a log of phone calls, especially long distance calls, to support direct program charges. Any charge on the phone bill for directory advertising should be charged to advertising. The base phone bill is allocated directly on an equitable basis; e.g., number/percentage of staff telephone instruments.

Base Monthly Charge: \$250.00		
Services	Number of Staff Equivalents	Allocated Costs
Area Agency on Aging	8	200
DOE	2	50
Totals	10	\$250

Travel

If an organization has a vehicle that is used for many purposes (such as a van used to transport clients, complete office errands and occasionally pick up or deliver within the production area), a mileage log should be maintained for each trip so that costs related to that vehicle can be distributed properly. Costs of vehicles that are used for a single purpose are charged to the appropriate service.

Transportation Costs For The Month		
Services	Mileage	Allocated Costs
DOE	4,000	1,000
Area Agency on Aging	1,400	350
Administration	0	0
Utility Company	600	150
Totals	6,000	\$1,500

Suggested Bases For Cost Allocation

Following are examples of bases for allocating costs of central-type services to departments or agencies and to projects and programs utilizing these services. Any method of distribution can be used, provided it results in an equitable distribution of costs.

In selecting one method over another, consideration should be given to the additional effort required to achieve a greater degree of accuracy.

TYPE OF COST ACTIVITY	POTENTIAL BASES FOR ALLOCATION
Accounting	Number of transactions processed (e.g., warrants, checks, PO's)
Auditing	Direct audit hours (one hour = 60 min.)
Budgeting	Direct hours of identifiable services of employees in central budget office.
Data processing	System usage
Disbursing service	Number of checks or warrants issued
Employees retirement system administration	Number of employees included
Legal services	Direct hours
Mail and messenger service	Number of documents handled or employees served
Motor pool costs, including automotive management	Miles driven and/or days used
Office machines and equipment maintenance and repairs	Direct hours
Office space use and related costs (heat, light, janitorial services, etc.)	Sq. ft. of space occupied
Organization and management services	Direct hours
Payroll services	Number of employees
Personnel administration	Number of employees
Printing and reproduction	Direct hours, job basis, pages printed, etc.
Procurement services	Number of transactions processed
Local telephone	Number of telephone instruments
Health services	Number of employees
Fidelity bonding program	Employees subject to bond or penalty amounts

Direct Cost Allocation Plan Documentation

The following supporting information would be part of a direct cost allocation plan.

- List of grants, contracts and agreements.
- Organizational chart.
- Job descriptions - for each general and administrative staff person.
- Worksheet for each employee showing personnel and non-personnel costs, chargeable hours and calculation of each employee's billing rate.
- Summary of non-personnel general administrative costs and allocation to each general and administrative position.
- Copy of the previous audit report supporting the total general and administrative costs used in calculating current cost allocations.
- Copy of the timesheet form that will be used by general and administrative staff.
- Copy of the monthly billings summary form that will be used to invoice each program.
- Space cost allocation for each building or property.

o Cost Allocation Plans

COST ALLOCATION PLANS

When preparing a cost allocation plan there are six focal areas. The plan must:

- Be written, comprehensive, approved by the organization's management and incorporated into overall operations.
- Be supported by formal accounting records and other documentation regarding the propriety or appropriateness of charges.
- Cover all direct and joint costs that are to be allocated, as well as the method used in distributing the costs.
- Describe the nature and extent of services provided and relevance to the program or programs to which the costs are to be allocated.
- Be consistently used when allocating expenditures to multiple-cost categories, with strict adherence to records retention requirements.
- Be made available to the organization's auditors and used as a working document during the audit process.

The above areas are supported by the regulations, which require:

- A plan for allocation of costs to support the distribution of any joint costs related to the grant program.

- A comprehensive, formal plan—in writing.
- All costs included in the plan must be supported by formal accounting records that substantiate the propriety of eventual charges.
- The plan is supported by complete and accurate accounting records that are, in turn, supported by appropriate documentation.
- The grantee's plan covers all joint costs of the organization, and/or organizational units, which are to be included in the costs of the federally sponsored programs. To the extent feasible, the cost allocation plan for all departments or units rendering services to the grantee's programs should be presented in a single document.
- The plan covers all direct and indirect costs that are to be allocated—in any manner—and indicates the allocation method to be used. A plan will identify costs that are going to be allocated, and explain how they will be allocated. It might also explain why some costs are not going to be allocated.
- The allocation plan should contain, but not necessarily be limited to, the following:
 - The nature and extent of services provided and their relevance to the federally sponsored programs.
 - The items of expense to be included.
 - The methods to be used in distributing the cost.
 - The procedures for following the plan consistently and properly—and documenting that this has been done—after its approval by all appropriate parties.

▪ **Summary**

When preparing or reviewing the cost allocation plan, be mindful of the standard components that must be included. The plan must ensure that basic cost principles are followed, that costs have been allocated on several levels, and that appropriate methods of cost allocation have been utilized. The following is a brief summary of key assumptions.

Basic principles of cost allocation:

- Some of the costs incurred by organizations benefit all of its projects, programs, and grants (although the benefits to each cannot always be calculated precisely).
- To the extent feasible and practicable, all benefiting projects, programs, and grants should share these organizational costs in close proportion to the benefits received.

- The shared costs that are difficult to determine precisely might be allocated using a method based on some agreed upon unit that can be measured exactly.

Costs are generally allocated on several levels:

- Between funding sources.
- Between programs funded by the same source.
- Between cost categories or activities within the same title or program.
- Between federally supported and nonfederal programs.

The basic methods of allocating shared costs include:

- Direct costs, without an allocation plan.
- Costs of shared benefits distributed directly by a cost allocation plan.
- Charges based on an approved indirect cost rate.

The allocation of costs requires the exercise of sound judgment derived from substantial experience. The involvement of key management personnel is essential as a safeguard against a strictly clerical approach that would result in allocations that do not accurately reflect the actual activities of the organization. It also is essential that there be adequate planning, careful selection and training of employees who submit time reports, and periodic checks on the actual results to ensure that they are reasonable in light of actual organizational operations.

**PARTICIPANT ACTIVITY FOUR
COST ALLOCATION**

LIST THE NINE ITEMS OF SUPPORTING DOCUMENTATION THAT MUST BE INCLUDED IN A COST ALLOCATION PLAN

1. _____
2. _____
3. _____
4. _____
5. _____
6. _____
7. _____
8. _____
9. _____

3. INDIRECT COSTS

Indirect costs are costs incurred for a common purpose, benefiting more than one program, and not readily allocable among individual programs based on their proportionate shares of benefits derived. All indirect costs must be negotiated with a *cognizant federal agency*. The cognizant federal agency is responsible for negotiating and approving indirect cost rates on behalf of all federal agencies that award grants and contracts to an organization.

An indirect cost rate reflects the relationship (calculated as a percentage) between the total indirect costs of a recipient organization and its total direct costs (exclusive of capital expenditures) or between the total indirect costs of an organization and a single component of its direct costs (e.g., direct salaries and wages). The rules for indirect costs are delineated below:

- Indirect costs are shared costs, to be distributed by an indirect cost rate, that must be grouped into one or more equitable cost pools to determine appropriate rate(s).
- An organization must submit for federal approval a formal proposal delineating those items to be included in its indirect cost pool. Once approval is granted, charges then can be distributed among programs, projects, and activities by means of an indirect cost rate.
- Application of an indirect cost rate must be supported by formal accounting records available for auditing.
- Like direct costs, indirect costs (or administrative costs) must be allowable under the federal government's cost principles.

In theory, all grant- and contract-related costs might be charged directly; however, practical difficulties preclude such an approach. Therefore, they are usually grouped into a common indirect cost pool and distributed through a cost allocation process among those organizational programs, projects, or activities that benefited from them.

o **Types of indirect cost rates.**

- Predetermined rate—negotiated, usually for one year, and not subject to adjustment.
- Fixed rate with carry-forward—adjusted in future period.
- Final rate—not subject to adjustment.
- Provisional rate—temporary, subject to adjustment.

o **Cognizant Agency**

A grantee's indirect cost rate must be negotiated/renegotiated with the appropriate, or "cognizant," federal agency. In order to negotiate an indirect cost rate with a specific

federal agency, a grantee must get all of its federal funding agencies to agree on which federal agency will serve as their representative in dealing with the grantee. When they have agreed upon such an agency, it then becomes the “cognizant agency” for the grantee’s negotiation of an indirect cost rate.

The cognizant agency approves, or disapproves, a grantee organization's indirect cost rate proposal *on behalf of all* federal agencies that provide funds to that organization. Once the cognizant federal agency approves the indirect cost rate, it becomes the rate accepted by all other federal agencies.

In carrying out this function, the cognizant agency will:

- Receive the grantee's indirect cost rate proposal.
- Review it in sufficient detail to reach a conclusion regarding an appropriate indirect cost rate.
- Negotiate, or reach an agreement, with the proposing organization regarding a rate *both* will find acceptable.

The cognizant agency has wide discretion in its review of an indirect cost rate proposal:

- It may request a full or limited audit by a Federal audit agency.
- It may conduct its own review of the grantee’s records, accounting system, and general operations.
- It may draw upon its experience with, and knowledge about, the grantee and negotiate an agreement without requiring an audit or review of records.
- It may, based its level of confidence in the reliability of the proposal as a true indicator of the grantee’s operations, reach an agreement quickly by phone or face-to-face negotiations.
- It will accept the organization's annual budget as a basis for preparation of the *first* indirect cost proposal. Thereafter, it will expect the use of actual (historic) financial data.

Upon agreement, the cognizant agency will formalize the accepted rate(s) in an indirect cost rate agreement and distribute the agreement to all other interested Federal agencies.

o **Determining The Appropriateness Of An Organization-wide Indirect Cost Rate**

Many organizations have found that the most reasonable way to allocate shared costs is to combine the direct allocation method with the application of an approved indirect cost rate (although not, of course, for the same costs).

In order for an organization to determine whether an indirect cost rate will be appropriate, they first must analyze current operations. This requires that the organization:

- Segregate its expenditures into:
 - General and administrative costs.
 - Fundraising (and/or other unallowable costs).
 - Other direct program and activity costs.
- Identify the *direct* costs of each program, project or grant.
- Identify *joint* costs of programs, projects, and grants, such as shared space, telephone services, and fiscal and administrative staff time. The joint costs then can be prorated as direct costs to each of the programs, projects, and grants that benefit. The amount to be charged to each program must be applied consistently, and there must be a basis or rationale for the cost.
- Identify the *indirect* costs of the organization, which are the remainder of organization-wide management and administrative costs.

Those costs that most equitably can be distributed through an indirect cost process include:

- Management and administrative salaries applicable to all programs
- Other costs applicable to all programs, such as:
 - Space rental
 - General use supplies
 - Basic telephone services
 - Photocopies
 - Insurance (e.g., liability and property)

Once all these costs have been identified, the organization would:

- review the number of programs impacted by an indirect cost rate,
- review the allowability of each proposed indirect cost, to ensure that regulations do not limit or prohibit the application of the indirect cost,
- analyze the time required to prepare an indirect cost proposal, and
- analyze the organization's capability to manage indirect costs.

Based on this review, an organization should be able to determine whether it would be appropriate to establish an indirect cost rate.

o Indirect Cost Rate Proposal

Before preparing the indirect cost rate proposal, the organization must determine what approach will be used and the type of indirect cost rate it wants to negotiate.

• Allocation Method

Various approaches or methods are available to grantees for computing their indirect cost rate(s):

- The simplified method.
- The multiple distribution base method

Both of these methods apply the same basic concepts for calculating costs:

$$\frac{\text{Indirect Costs}}{\text{Direct Costs}} = \text{Indirect Cost Rate}$$

(Indirect Costs divided by Direct Costs equals Indirect Cost Rate)

That is all there is to calculating an Indirect Cost Rate. The differences in all of the various methods are simply matters of *refinement*. The simpler the approach, the easier it is to manage the indirect cost rate.

• Distribution Base

The organization must identify the distribution base for calculating the indirect cost rate. The most widely accepted distribution bases are:

- Direct Labor Costs
- Direct Labor and Fringe Benefits Costs
- Total Direct Costs (TDC)
- Modified Total Direct Costs (TDC minus an unusual or nonrecurring component, such as contractual services or equipment purchases)

The following supporting information would be part of an indirect cost proposal:

- List of grants, contracts and agreements
- Organizational chart
- Actual indirect and direct expenses for the most recent year ended (this applies in the second year of negotiation and all years thereafter)
- Calculation of actual indirect cost rate for the most recent year ended

- Proposed budget for indirect costs in the next year
- Proposed organization-wide budget for the next year
- Calculation of the proposed indirect cost rate for the organization is based on the proposed budgets for indirect and direct costs in the next year.
- Accounting policies for the organization demonstrating that financial procedures meet standards and will provide adequate documentation of costs.
- Other information that the cognizant agency requests to negotiate the indirect cost rate.

o **Management of Indirect Costs**

When using indirect cost rates, the accounting system will accumulate all organization-wide common, shared, or indirect costs in a *pool*, or cost center. It is necessary then to change budgeting procedures to coincide with accounting practices.

- Indirect, shared, or common costs are accounted for as individual line items in the *indirect cost pool*, but subsequently are allocated as a single-line item category of “indirect costs” to programs and activities. The allocation is based on either the provisional, fixed, or actual indirect cost rate used or developed by the accounting system.
- An appropriate share of indirect costs is budgeted within each grant, program or activity based on the provisional or fixed rate, regardless of funding constraints.
- Indirect costs are a vital part of budgeting the full costs of program activities.
- A standard form budget format should be established for all programs in a multi-funded organization, and the full indirect cost rate should be applied to all programs as a matter of accounting policy and standard budgeting procedure.
- Actual indirect costs are monitored organization-wide within the indirect cost pool, which contains a line-item budget. The accounting system documents indirect charges by line item for comparison with the annual indirect cost budget, which was derived from the organization's indirect cost rate proposal.
- The actual indirect cost rate is calculated monthly in the accounting system using year-to-date base and indirect cost amounts. Each program's share of indirect costs is shown in a monthly financial report for comparison to indirect cost budgets.
- Supplemental reports will show prorated line item indirect costs comprising the total indirect cost share. The line item amounts are useful in a transition phase and may

have continuing use for budgeting, accounting, and financial reporting until affected employees become familiar with indirect costing concepts and adept in their use.

- Organization-wide cost containment and management of indirect costs most effectively can be exercised through internal evaluations of the indirect cost pool.

▪ **Summary**

Indirect costs are not different from any other costs; however, the procedures for documenting and claiming them *is* different. Therefore, organizations must carefully analyze the feasibility of establishing an indirect cost rate prior to initiating the process for establishing the rate.

Indirect costs should be managed as carefully as any other organizational operating costs. Once an indirect cost budget is established, it should be monitored closely, not only to recognize expenditures but also to ensure that budgeted revenues are received and shortfalls are recognized.

The determination of the method to be used to calculate the indirect cost is very important. Organizations need to meet their own requirements for complexity while at the same time keeping the method as simple as possible.

The determination of the indirect base is critical if an organization wants to achieve a stable base budget and ensure that revenues expected from indirect cost reimbursements actually are generated.

Key Points To Remember

- Costs included in the indirect cost pool cannot also be charged directly to programs.
- If it were practicable to do so, all costs would be charged to programs on a direct basis.
- Both indirect and direct costs must be allowable under the federal cost principles.
- Funds spent on administrative costs are not available for direct program use.
- Many funding sources limit the amount of total administrative costs (direct and indirect).
- Funds spent on administrative costs and not charged to the program receiving the benefit of those costs, must be supported by other resources of the organization; e.g., when there is a statutory limit on indirect costs associated with a particular grant, the recipient organization must be able to pay the difference between the indirect costs incurred and the indirect costs reimbursed.

**PARTICIPANT ACTIVITY FIVE
INDIRECT COST**

CALCULATE THE PROPOSED INDIRECT COST RATE

October 1, 2002 through September 30, 2001 Revenue	Total Budget
State Agency on Aging	1,003,838
Title XX	127,173
Tribal Water Systems	118,347
AIDS	119,808
Indian Health Services	100,000
Environmental Protection Agency	984,333
Women, Infants, and Children	4,075,174
Bureau of Indian Affairs	274,305
HHS – Center for Disease Control	54,109
TOTAL	6,857,087

	DIRECT	INDIRECT	EXCLUDED
Personnel	752,481		156,750
Fringe Benefits	167,232		29,451
Travel	144,001		700
Contractual	2,267,646	2,072,932	12,750
Supplies	24,791		1,000
Equipment	58,100	58,100	0
Postage	10,298		2,250
Printing	49,167		4,580
Telephone	19,010		3,000
Conference	16,556		500
Education Material	10,825		200
Food	2,842,430	2,842,430	0
Consultants	48,474		14,000
Vehicle Maintenance	5,400		0
ADP	43,000		5,000
Rent	61,708		12,640
Dues/Subscriptions	3,652		2,711
Trainee Expenses	32,629		4,155
Insurance	13,000		3,000
Equipment Rental	14,000		20,000
TOTAL	\$6,584,400	4,973,462	272,687

Proposed Indirect Cost Rate: _____ = _____%

4. ALLOWABILITY OF SELECTED COSTS

The charts on the following pages provide quick references to specific items of cost, indicating whether each cost is generally allowable or allowable only with approval of the granting agency.

OMB COST PRINCIPLES - Selected Items of Cost

Cost Category	A-87 State & Local Governments (Proposed Revision)	A-122 Nonprofit Organization	Allowable	Allowable With Approval	Not Allowable
Accounting	X		X		
Advertising - Specific Purchases	X	X	X		
Advisory Council	X		X		
Alcoholic Beverages		X			X
Audit Services	X		X		
Automatic data processing	X			X	
Bad Debts	X	X			X
Bid and proposal costs (reserved)		X			
Bonding Costs	X	X	X		
Budgeting	X		X		
Building lease and management	X		X		
Communication costs	X	X	X		
Compensation for personal services	X	X	X		
Contingency provisions	X	X			X
Contributions	X	X			X
Defense and Prosecution Read Allowability	X	X			
Depreciation of use allowance	X	X	X		
Disbursing services	X		X		
Donations		X			X
Employee morale, health and welfare costs and credits	X	X	X		
Entertainment costs	X	X			X

**PARTICIPANT ACTIVITY SIX
ELIGIBLE AND INELIGIBLE PROGRAM COSTS**

For each of the situations described below, make a recommendation as to whether the resulting expense is eligible to be charged to the grant.

ISSUE FOR DISCUSSION	RECOMMENDATION	RATIONAL FOR COMMENT
1. Advertising for a Finance Director to run the organization's accounting department.		
2. Advertising for a Program Director for the weatherization program		
3. Dinner expense for a weatherization program staff to meet with a local charitable foundation member to discuss some fundraising strategies.		
4. Aaron spends 100% of this 80-hour pay period time on weatherization activities under Grant 1. In addition, on his own time, he spends 2 hours a week on organized fundraising for the State's weatherization projects and 1 hour a week on lobbying his Congressional delegation to support the weatherization programs.		
5. Long distance calls for Weatherization Project Director to the DOE to discuss some programmatic issues.		
6. Donations to local charity		
7. What documentation is required for the administrative cost of the weatherization program if the agency has an indirect cost rate?		
8. The weatherization crew installs a wheel chair ramp for an elderly client.		

ISSUE FOR DISCUSSION	RECOMMENDATION	RATIONAL FOR COMMENT
<p>9. The weatherization program received the following items and services donated to the organization and the Finance Director needs guidance on accounting for them:</p> <ul style="list-style-type: none"> • Weatherstripping valued at \$1,000 • Video equipment cost \$6,000 • Consulting by a specialist in client education for 4 hours @ \$75 per hour rate • David Robinson, a professional basketball player provided a motivational speech for 2 hours @ \$5,000 per hour rate (Based on his current salary) 		
<p>10. Cost of consultant @ \$300 per day to raise funds for the organization.</p>		
<p>11. Expenses incurred during the period before the program actually started including writing of grant application, totaled \$4,000.</p>		
<p>12. Four hours spent by the Program Director lobbying the state's Senator in Congress to support Weatherization.</p>		
<p>13. Purchase of \$2,000 computer to be used exclusively for weatherization project.</p>		
<p>14. Administrative Assistant, who works 100% on weatherization program activities, monthly salary of \$1,000.</p>		

OMB COST PRINCIPLES - Selected Items of Cost

Cost Category	A-87 State & Local Governments (Proposed Revision)	A-122 Nonprofit Organization	Allowable	Allowable With Approval	Not Allowable
Equipment and other capital expenditures	X	X		X	
Fines and penalties	X	X			X
Fringe benefits	X	X	X		
General government expenses	X				X
Goods/services for personal use		X			X
Housing and personal living expenses		X			X
Lobbying	X	X			X
Idle facilities and idle capacity	X	X		X	
Independent research and development (reserved)		X			
Insurance and indemnification	X	X	X		
Interest, fund-raising, and investment management costs - read the regulations	X	X			X
Labor relations costs		X	X		
Legal expenses	X	X	X		
Losses on other awards	X	X			X
Maintenance and repair costs	X	X	X		
Materials and supplies	X	X	X		
Meetings, conferences	X	X	X		
Memberships, subscriptions and professional activity costs	X	X	X		
Motor pools	X		X		
Organization costs		X		X	
Overtime, extra pay, shift and multi-shift premiums	X	X	A-87	A-122	

OMB COST PRINCIPLES - Selected Items of Cost

Cost Category	A-87 State & Local Governments (Proposed Revision)	A-122 Nonprofit Organization	Allowable	Allowable With Approval	Not Allowable
Page charges in professional journals		X	X		
Participant support costs		X		X	
Patent costs		X	X		
Payroll preparation	X		X		
Pension plans	X	X	X		
Personnel administration	X		X		
Plant security costs		X	X		
Pre-award costs	X	X		X	
Professional costs	X	X	X		
Profit and losses on disposition of depreciable property or other capital assets	X	X	X		
Proposal costs	X			X	
Publication and printing costs	X	X	A-87	A-122	
Rearrangement and alteration costs	X	X		X	
Reconversion costs	X	X	X		
Recruiting costs		X	X		
Relocation costs - subject to limitations		X	X		
Rental costs	X	X	X		
Royalties and other costs for use of patents and copyrights		X	X		
Severance pay	X	X	X		
Specialized service facilities		X	X		
Taxes	X	X	X		
Termination costs		X	X		
Training and education costs	X	X	X		
Transportation costs	X	X	X		
Travel costs	X	X	X		
Trustee Travel and Subsistence		X	X		
Under recovery	X				X

CHAPTER FOUR

BUDGETING AND FINANCIAL PLANNING

A. INTRODUCTION

Planning is, or should be, a continuous process. This also is true of budgeting, particularly in the development of background cost and expenditure data.

Three Phases of Budgeting

- Preparation of the budget. Organizational and program budgets should not be prepared until the governing policies, priorities, and plans have been developed. Without clearly stated goals and objectives, budgets (or *financial projections*) cannot be developed—nor should budgeting be used as a substitute for good planning. Approval of the budget should be regarded as a commitment on the part of the governing body and the administration to carry out its governing policies, respect its priorities, and support the plans that have been translated into dollar expenditures through the budget.
- Comparison of the budget to actual results. The second step in budgeting is comparing planned expenditures to actual expenditures. This comparison must be done at regularly scheduled intervals in order for the budgeting process to serve its function as a control tool.
- Reaction to differences between budgeted outcomes and actual outcomes. There are two basic actions that can be taken when actual expenditures differ from planned expenditures: (1) change nothing and (2) make a change in procedures or approaches.

Factors in Budgeting.

Budgeting is the method by which an organization translates its overall and/or programmatic goals and objectives into estimates of the resources necessary to accomplish them. Budgeting is not a hit-or-miss approach. Rather, it involves serious consideration of many factors, including:

- Available Resources. Analysis of available resources involves identifying the people, facilities/equipment, and cash available to achieve organizational and programmatic goals and objectives. This analysis includes resources most commonly referred to as *human* resources, *capital* resources, and *financial* resources. If the budgeting process does not assess the availability of all three types of resources, it is less likely to facilitate achievement of the goals and objectives.
- Regulations that govern programs. The budgeting process must assess the impact that all applicable regulations will have on the allocation of resources to

the various line items. If this is not done, the organization will spend excessive amounts of time attempting to force expenditures into inappropriate cost categories.

- **Scope and Quality of Service and Methods of Service Delivery.** One of the most important factors in determining expenditures is the range and quality of services to be provided. This also must include the methods to be used to provide the service. Rather than basing the budget solely on past expenditures, the organization should look at alternative ways of providing the services during the budgeting process.
- **Volume of Activity.** The volume of activity must be analyzed to determine fixed costs and those that are impacted by an increase or decrease in funding level (or number of houses to be weatherized). The organization must establish a base level at which its program(s) can be operated effectively. If this level of revenue is not secured, the organization will be compelled either to generate additional revenue, combine programs with similar goals, or refuse to administer the program.
- **Cost elements.** The organization will need to determine the various types of labor, materials, equipment, and other costs required to perform the services—and then estimate expenditures of each type of cost.

B. TYPES OF BUDGETS

There are four types of budgets that must be developed by organizations. Although most see themselves as having individual program budgets as well as an overall organizational budget, they also require the four budgets detailed below.

- **Revenue Budget.** The revenue budget is a summary of the expected revenues to be received by the organization in a fiscal year; it often is based on revenues received in a prior year. In many organizations, the budgeting process begins with a projection of expected revenues. It is important to consider changes that might occur, including expansions or reductions of government programs, the introduction of new programs, and the elimination of old programs.
- **Cash Budgets.** Cash budgeting is a projection of required cash receipts and cash disbursements for a given period of time; e.g., a month, a quarter, or a payroll period.

The purpose of the cash budget is to ensure that the organization has enough cash on hand to pay bills timely, meet payroll requirements, etc. This is not as easy as it sounds because the organization must comply with federal cash management regulations, including restrictions on idle cash balances in checking accounts. Thus organizations must have the internal controls necessary to safeguard cash. A systematic analysis of *cash flows* (into and out

of an organization) always begins with an analysis of the operating budget. Capital budgets also must be reviewed to ensure that cash is available for major purchases. This typically is done through cash flow analysis, which simply reviews and/or predicts the timing of cash payments for expenditures.

Cash budgets can be prepared for any period of time that fits the needs of the organization. Typically cash budgets are prepared annually, and cash flows are reconciled monthly or weekly. To make the analysis even more complex, it also is necessary to factor in the lapse of time between requests for funds and receipt of funds from each funding source. Documentation of cash needs over a period of time will assist in preparation of future cash flow projections.

For a cash budget to be successful, cash receipts and disbursements must be projected systematically and accurately.

- **Capital Budgets.** Capital budgets are resources set aside for acquisitions of land, buildings, or equipment. If government funds are to be used, it is necessary to plan operating expenses in such a manner as to "free up" the resources capital expenditures.

If non-restricted funds are to be used, long-term planning decisions are necessary to ensure financing of the purchase. Also, organizations should analyze the "payback period" on a capital purchase to ensure that the investment is recoverable in a reasonable timeframe.

If a capital purchase is required to perform ongoing activities, it is important that the organization plan far enough in advance to ensure that resources are available when needed.

- **Expense Budgets.** Expense budgets show where the money should go by focusing on operating, administrative, and other expenses. Five categories of expenses are used to prepare expense budgets:
 1. **Variable expenses.** A variable expense is one that increases and decreases according to organizational activity levels. Weatherization materials are a good example of this—the more weatherization projects performed, the higher the variable materials expense.
 2. **Non-variable (or "fixed") expenses.** These are organizational expenses that do not increase or decrease according to organizational activity levels. Rent is a good example of a non-variable expense.
 3. **Semi-variable expenses.** These are expenses that increase or decrease in less than perfect proportion to organizational activity levels. Utilities with a fixed base rate, in combination with a usage rate, are a good example of semi-variable expenses.

4. Step expenses. These are non-variable costs that can be changed by management. One example of this expense is the cost of hiring an outside consultant.
5. Other expenses. There are several costs that do not fit into any of the foregoing categories. Federal payroll tax and state unemployment tax are good examples of these.

C. METHODS OF BUDGETING

There are two basic methods of budgeting used by non-profit organizations. The first is *incremental budgeting* which is nothing more than budgeting based on changes between items in the previous and current budgets when the planning period is one year or one budget period. This type of budgeting is used when the organization is continuing existing programs and not expanding into new programs. Incremental budgeting allows the organization to improve current program operations.

The second type of method used by many non-profit organizations is a form of the *planning, programming, and budgeting system* (PPBS) developed in the 1960's. The PPBS requires an organization to measure and classify costs according to programs and resources used currently and to be used in the future to achieve the organization's goals and objectives. The objectives are then matched against resources for both planning and evaluation. A multi-year budget is used to detail current and projected costs of programs.

In preparing the budget, the organization must analyze each cost currently incurred, classify the cost appropriately, and then estimate the cost for the future budget period.

When an organization uses an incremental budget, they need to analyze the prior year's expenditures and incorporate any revisions due to changes in revenues.

The budget on the following page is an example.

Incremental Budget

Line Item	DOE FY 2003 Expenses	DOE FY 2004 Budget
Administration	10,000	11,000
Training and Technical Assistance	10,000	11,000
Program Operations	164,000	180,000
Health and Safety	14,000	15,400
Vehicle and Equipment	6,000	6,600
Liability Insurance	4,000	4,400
Leveraging	2,000	2,200
Financial Audit	0	0
TOTAL	\$210,000	\$231,000

This type of budget is very easy to develop and more advantageous than simply redoing the previous year's budget. However, it does not take into account the particular types of houses that will be weatherized.

An organization that is going to use the PPBS style of budgeting will have to analyze the following:

- New regulations that will have an impact on the weatherization operations.
- Types of houses that the program staff identifies for weatherization in the new budget year.
- The cost of weatherizing similar houses during the current year.
- Changes in the weatherization work to be performed in the next year.
- The cost to implement anticipated changes.
- The projected increases in costs for labor, materials, insurance, etc.
- Equipment purchases that might be needed.
- New activities that the program wants to undertake and their expected costs.

After analyzing all of the above items, the same organization might end up with a budget that looks like the one below.

PPBS Budget

Line Item	DOE FY 2003 Expenses	DOE FY 2004 Budget
Administration	10,000	11,000
Training and Technical Assistance	10,000	11,000
Program Operations	164,000	180,000
Health and Safety	14,000	15,400
Vehicle and Equipment	6,000	6,600
Liability Insurance	4,000	4,400
Leveraging	2,000	2,200
Financial Audit	0	0
TOTAL	\$210,000	\$231,000

The other step that must be taken when preparing a DOE weatherization budget is to ensure that all costs have been allocated to the proper cost category. This will require that an organization review each of its line items.

Budget By Line Item

Line Item	Admin.	T/TA	Program Operations	Health And Safety	Vehicles And Equipment	Liability Insurance	Leveraging	Financial Audit	Total
Personnel	5,000	4,000	78,768	5,000	0	0	4,000	0	96,768
Fringe	1,000	800	19,692	1,000	0	0	800	0	23,292
Travel	2,500	6,200	1,000	0	0	0	0	0	9,700
Equipment	0	0	0	0	25,000	0	0	0	25,000
Supplies	700	0	55,940	1,500	0	0	200	0	58,340
Contractual	0	0	0	0	0	0	0	0	0
Construction	0	0	0	0	0	0	0	0	0
Other	1,800	0	12,000	0	0	4,100	0	0	19,900
Total Direct	11,000	11,000	167,400	7,500	25,000	4,100	5,000	0	231,000
Indirect Charges	0	0	0	0	0	0	0	0	0
TOTAL	11,000	11,000	167,400	7,500	25,000	4,100	5,000	0	231,000

Budgeting is a major component of the program/project planning process; however, the full benefits of well-developed budgets are realized only when they are used for program implementation and cost control.

D. MANAGEMENT

Good management requires that funds be used efficiently and effectively; that is, when maximum benefits are derived from the resources invested. One tool for achieving such efficiency and effectiveness is proper budget management. In order to do this, organizations must compare their planned expenditures to their actual expenditures at frequent intervals. As differences, or *variances*, between planned and actual expenditures are identified, questions should be raised about their underlying causes, including the following:

- Limited planning information. Frequently the cost to do a project is inaccurately projected because it is a new activity and the organization does not have historical data to guide its budgeting process.
- External factors. Sometimes there is a major, unanticipated increase in the costs of materials or equipment; other external causes include new laws or regulations that require additional person hours to complete a planned activity.
- Internal factors. An unanticipated and/or prolonged position vacancy may impact a program/project significantly.

The DOE budget can be monitored in two ways:

Line-Item Review. On a periodic basis, preferably monthly, administration and program staff can review the expenditures for each line item. In order for this to result in an accurate assessment of program/project progress toward established goals, the production schedule must be factored into the analysis.

In order to conduct a line-item review, a projection of expenditures must be prepared. Many organizations divide the total budget by twelve to determine the planned expenditures for each month. Although this works for fixed costs, it does not work for other costs that are impacted by rates of production. To accurately project expenditures, the production schedule must be taken into account when preparing the projection.

Dwelling Unit Cost. The DOE Weatherization Program is driven by production, and production costs are an important part of program monitoring. Regulations also mandate that the *dwelling unit costs* (costs per unit of housing weatherized) be monitored closely to ensure compliance with DOE regulations and the overall budget.

Making budget changes in response to identified cost variances is an ongoing process and should occur as soon as the variances are identified. Understanding and responding to variances will improve planning methods and future budgets.

E. COST CATEGORIES

In 10 CFR 440.18, the Department of Energy has established specific cost categories for all program expenditures; these include:

- Administrative
- Training and Technical Assistance
- Program Operations
- Health and Safety
- Vehicles and Equipment
- Liability Insurance
- Financial Audit

Administrative.

The costs incurred to administer a program could include, but are not limited to, indirect costs, administrative staff, accounting staff, office space, telephone, postage, printing, payroll processing, and/or lease of office machines. The administrative cost category is limited to a 10 percent maximum, and not less than 5 percent must be passed on to sub-grantees. The state can provide up to an additional 5 percent in administrative funds for sub-grantees that receive less than \$350,000.

Training and Technical Assistance.

Training and technical assistance includes the cost to train and/or provide technical assistance to grantees and sub-grantees. These costs could include travel to training, staff time for training, technical materials, supplies used in training and technical staff time required to provide energy conservation education to residents of eligible dwelling units, materials for conservation education, or travel to conduct conservation education.

Program Operations

Program operating costs include materials, program support less labor, and labor. *Materials* include the purchase and delivery of weatherization materials. Materials must meet or exceed standards established in 10 CFR 440.

Program support contains a number of cost items that are necessary for operation of the DOE Weatherization Program:

- Transportation of weatherization materials, tools, equipment, and work crews to a storage site and to the site of weatherization work.
- Maintenance, operation, and insurance of vehicles used to transport weatherization materials.
- Maintenance of tools and equipment.
- Purchase or annual lease of tools, equipment, and vehicles. (The regulations also state that purchases of vehicles always require prior DOE approval.)
- Storage of weatherization materials, tools, and equipment.

The labor component of the program operations category includes initial inspectors, quality control persons, field supervisors who are not installing materials, and warehouse personnel.

Labor category expenditures are limited to those defined in 10 CFR 440.19, including:

- Wages paid to training participants, public service employment workers, or other Federal or state training program employees;
- Payments to subcontractors;
- Salaries and fringe benefits of crew leaders and crew members.

Health and Safety.

This includes the cost to eliminate health and safety hazards as deemed necessary before weatherization work can be done, or that will be necessary as a result of the installation of weatherization materials. This includes such items as venting for space heaters, space heaters, testing equipment and supplies.

Vehicles and Equipment with a Cost of \$5,000 or more

- *Vehicles and equipment* means tangible, nonexpendable, personal property having a useful life of more than one year and a per-unit acquisition cost of \$5,000 or more. A grantee may use its own definition of vehicles and equipment provided that such definition at least includes all equipment defined above.
- List the full price of vehicles and equipment purchased at a per-unit cost of \$5,000 or more in the budget. The amortized amount will be reported quarterly if the *State elects*. Provided the vehicle or equipment item cost \$5,000 or more and has a useful life exceeding one year, States are permitted to include in their average cost calculations only that fraction of the cost that actually was “used” during the current year; see §440.18(b)(3). Such an approach does not affect

the ability of States or local agencies to use current funds to pay the full cost of such purchases.

- Grantees are required to obtain DOE approval prior to purchasing new vehicles and equipment.

Liability Insurance.

Liability insurance includes the cost of an insurance policy for personal injury and property damage for weatherization projects. The policy should be comprehensive, cover the work that is being done at the homes, and cover personal injury for the staff at all times.

Leveraging.

Leveraging is performing activities that will lead to securing non-federal resources to conduct weatherization activities. This could include staff time, reference materials, printing, or travel.

Financial Audits.

The *financial audit* category covers the cost to employ a Certified Public Accountant to audit the organization/program in compliance with the requirements of 10 CFR 440.23(d), which implements OMB A-133 Single Audit Act .

Preparing the Budget

It is important to develop the overall program operations budget and then prepare sub-budgets for each of the cost categories detailed above. This can be done through a simple spreadsheet similar to the one on the previous page.

F. SUMMARY

The Department of Energy is unique—although the budget line items are the same as for other federal programs, there are eight cost categories in which the line-item expenditures can be classified. To ensure proper financial control of expenditures, all staff should have a working knowledge of each of the cost categories and how to assign expenditures to the proper category.

Before the budget can be used as an effective management tool, time must be committed to the preparation, comparison, and monitoring phases of budgeting. Also, administration and program staff must support both the budget and any subsequent adjustments to the budget.

PARTICIPANT ACTIVITY SEVEN BUDGETING

**THE STATE HAS JUST INFORMED YOU THAT YOUR FUNDING FOR NEXT YEAR IS \$30,000
PREPARE A BUDGET.**

Item	Admin	T&T A	Program Operations	Health & Safety	Vehicles & Equipment	Liability Insurance	Leveraging	Financing Audit	Total
Personnel									
Fringe									
Travel									
Equipment									
Supplies									
Contractor									
Construction									
Other									
Total Direct									
Indirect									
Total Costs									