

# IV. ACCOUNTING

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Effective Date: April 21, 2008

## C. ALLOWABLE COSTS

Expenditures of State funds by any grantee shall be in accordance with the Cost Principles outlined in the Office of Management and Budget (OMB) Circular A-87. If the grant funding includes federal sources, the grantee shall ensure adherence to the cost principles established by the Federal Office of Management and Budget. (09 NCAC 03M .0201 Allowable Uses of State Funds Effective July 1, 2005) Nonprofit organizations are to use OMB Circular A-122, Cost Principles for Non-Profit Organizations, if the grant includes federal funds.

The total cost of a grant or award is the sum of the allowable direct costs as well as allowable indirect costs less any applicable credits. In order to be an allowable cost, certain criteria must be satisfied:

- 1. Be reasonable and necessary for the performance and administration of the award/grant and be allocable to the activity.**
- 2. Be authorized or not prohibited under State, Federal, or local laws/regulations and approved by the funding agency.**
- 3. Conform to any limitations or exclusions set forth either in applicable cost principles or the grant award as to type or amount of cost items.**
- 4. Be consistent with policies and procedures that apply uniformly to both State financed programs and other activities of the grantee organization.**
- 5. Be accorded consistent treatment and be determined in accordance with either generally accepted accounting principles or another comprehensive basis of accounting.**
- 6. Not be included as a cost or used to meet cost-sharing or matching requirements of another State financed program in either the current or prior period.**
- 7. Be adequately documented with time and attendance payroll records, personnel activity reports, or other time and effort records for employees charged to State awards or to more than one activity. Other types of documentation may include approved purchase orders, receiving reports, vendor invoices, canceled checks, etc. In addition, the costs must be correctly charged on the financial records as to account, amount, and period.**

A cost is considered to be reasonable if, in its nature or amount, it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time a decision

is made to incur the cost. Consideration must be given to whether the cost is of a type generally recognized as ordinary and necessary for the operation of the organization, the performance of the award, or the provision of services.

A cost is allocable to a particular cost objective, such as a grant, project, service, or other activity, in accordance with the relative benefit received by the cost objective. In order for a cost to be allocable to a State grant or award, the cost must be treated consistently with other costs incurred for the same purpose under like circumstances. The cost must benefit both the award and other activities of the organization and be distributed to the cost objective in a reasonable proportion to the benefits received although a direct relationship to a particular cost objective cannot be shown. It should be noted that any cost allocable to a particular award or cost objective cannot be shifted to other State awards either to overcome funding deficiencies or to avoid restrictions imposed by law or by the terms of the award.

Direct costs are those that can be identified specifically with a particular final cost objective, such as a particular award, project, service, or other direct activity of the organization. However, a cost may not be assigned to an award as a direct cost if any other cost incurred for the same purpose, in like circumstances, has been allocated to an award as an indirect cost. Costs identified specifically with awards are direct costs of the awards 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 other awards directly or indirectly. However, any direct cost of a minor 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.

The costs of certain activities are not allowable charges to State awards. However, even though these costs are unallowable for purposes of computing charges to State awards, they must be treated as direct cost by the grantee organization for purposes of determining indirect cost rates. Such costs must be allocated their share of the organization's indirect costs when the costs represent activities which benefit from the organization's indirect costs.

Indirect costs represent costs that have been incurred for common or joint objectives and cannot be readily identified with a particular final cost objective. Direct cost of minor amounts may be treated as indirect costs for reasons of practicality where the accounting treatment for such costs is consistently applied to all cost objectives. After direct costs have been determined and assigned directly to awards or other activities as appropriate, indirect costs are those remaining to be allocated to benefiting cost objectives. A cost may not be allocated to an award as an indirect cost if any other cost incurred for the same purpose, in like circumstances, have been assigned to an award as a direct cost.

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 cost in all situations. However, typical examples of indirect costs for many nonprofit organizations may include depreciation or use allowances on buildings and equipment, cost of operating and maintaining facilities, general and administrative expenses, such as officers, personnel administration, and accounting.

Where a not-for-profit organization has only one major function or all major functions benefit from indirect costs in approximately the same degree, the allocation of indirect costs and the computation of an indirect cost rate may be accomplished through simplified allocation procedures. However, where an organization has several major functions which benefit from indirect costs in varying degrees, the allocation of indirect costs may require an accumulation of such costs into separate cost groupings which then are allocated individually to benefiting functions by means of an allocation base which best measures the relative degree of benefit. Indirect costs which have been allocated to each function are then distributed to individual awards and other activities within that particular function by means of an indirect cost rate. The

determination of what constitutes major functions will depend on the organization's purpose, types of services rendered to the public, clients, and members as well as the amount of effort devoted to activities such as fund raising, public information, and membership activities.

The base period for the allocation of indirect costs is the period in which such costs are incurred and accumulated for allocation. The base period normally should coincide with the organization's fiscal year, but in any event should be a period which avoids inequities in the allocation of indirect costs.

Many non-governmental entities receive federal funds/grants directly from a federal agency. The Federal cognizant agency approves (or disapproves) such an entity's indirect cost rate(s) on behalf of all federal agencies that provide funds to that organization. Once the Federal cognizant agency approves the rate, it is expected to be accepted by other agencies when determining the amount of indirect costs applicable to their contracts and programs. As a general rule, the cognizant agency is the federal agency that provides the largest amount of funds to a non-governmental entity over a certain period of time. Therefore, if a non-governmental entity receives funding directly from a federal agency (or agencies), the Federal cognizant agency shall be established. The Federal cognizant agency may provide technical assistance and guidance to entities on how to prepare a proposal requesting establishment and approval of an indirect cost rate.

In situations where a non-governmental entity does not receive funds directly from a federal agency and where no Federal cognizant agency is designated, an indirect cost rate may be established using criteria and cost principles outlined in the applicable federal circular. Under these conditions, a person or firm, preferably one knowledgeable of this subject should establish the rate. **This person or firm should not be associated with the audit firm that conducts an audit of the entity's records.** Once a rate has been established, this person or firm should certify in writing to the non-governmental entity that the rate has been established in accordance with the applicable federal circular and that the documentation should be maintained and made available to any auditor requesting such information. The entity should also provide a copy of the letter to any and all agencies with whom they contract and from whom they wish to claim reimbursement of indirect costs.

When making application to a State agency for possible funding of a particular program or activity, the grantee organization should make specific inquiry relative to allowable direct and indirect costs and applicable cost principles.