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EPA

Preparing Indirect-Cost Rate Proposals For Grants And Contracts

Guide For Nonprofit Organizations

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PREFACE

This brochure is a guide for nonprofit organizations subject to the provisions of Office of Management and Budget (OMB) Circular A-122 to assist in understanding the concept of indirect cost rates and to help in preparing indirect cost rate proposals for Federal grants. The guidelines apply to most situations for nonprofit organizations.

Section I provides general information on the nature of indirect costs and indirect cost rates.

Section II provides guidelines for preparing an indirect cost proposal.

Section III provides guidelines for submission of an indirect cost proposal.

Appendix 1 provides a sample indirect cost proposal format.

Appendix 2 provides the information needed from the organization to support an indirect cost rate proposal and EPA's evaluation.

Appendix 3 includes revision to OMB Circular A-122, "Cost Principles for Nonprofit Organizations", to clarify requirements for maintenance and access to records for costs associated with legislative lobbying and political activities.

Appendix 4 includes OMB Circular A-122, "Cost Principles for Nonprofit Organizations".

Appendix 5 includes a sample form of a certification by an authorized organization official.

SECTION I - Indirect Costs - General Information

Nature of Indirect Costs

Indirect costs are joint or common costs benefiting more than one program and not readily identifiable with a specific program. Rent, heat, light, power, accounting, payroll, personnel, and administration are costs typically considered indirect costs.

Indirect Costs on EPA Grants

If indirect costs are proposed on a grant, the means by which the indirect cost are estimated must be supported by either, (1) a federally approved indirect cost agreement effective for the period of performance of the grant or, (2) an indirect cost proposal which supports the indirect costs proposed.

Indirect Cost Rate

The easiest means to determine the amount of common or joint costs to be borne by each program is to use an indirect cost rate. An indirect cost rate is computed by grouping joint or common costs into a pool and dividing the pool by a cost base common to all programs. The result is an indirect cost rate. The rate is applied to the base costs of a program to determine the share of indirect cost to be allocated to that program.

An indirect cost rate is not a percentage that is guessed at. It is a logical means to determine the amount of joint or common costs each program should bear. The rate is computed using accounting data (budget or actual) of the organization and a base that approximates benefits received from the indirect cost pool.

Indirect costs are reimbursed based on an organization's indirect cost rate, subject to any statutory or administrative limitations, OMB Circular A-122 "Cost Principles for Nonprofit Organizations", or the Environmental Protection Agency grant regulations.

Provisional Rate

A provisional indirect cost rate is an estimated rate established to permit funding and reporting indirect costs pending establishment of a final rate. The estimated rate may be based on actual costs of the most recently completed fiscal year or budgets. But, in any case, the provisional rate should be calculated using the best estimate of what is expected to be incurred during the performance period of the grant.

Final Rate

A final indirect cost rate is a permanent rate established after actual costs for a specific period (usually a fiscal year) are known. Final rates are used to adjust indirect costs initially claimed based on provisional rates.

SECTION II - Preparation of an Indirect Cost Proposal

There is no single method to prepare an indirect cost rate proposal. There are as many methods as accounting systems. However, there are several basic steps that must be followed in all cases. These steps are:

1. Determine the Accounting Data. The first step in preparing an indirect cost rate proposal is to decide on the accounting data to use for estimating the indirect cost rate: historical costs or budgetary data. For estimating future rates, the data selected should approximate the costs that will be incurred during the performance of the grant.

2. Classify Costs. Once the accounting basis for estimating the rate is selected, the next and most difficult step is to analyze each element of cost and decide which costs are indirect and which are direct. Because of the diverse characteristics and accounting practices of nonprofit organizations, it is not possible to specify the types of cost which may be classified as indirect in all situations. But, there are two fundamental concepts to keep in mind when classifying costs: 1) indirect costs are joint or common costs and 2) costs must be treated consistently.

Indirect costs are costs incurred for common or joint purposes and cannot be readily identified to a particular final cost objective such as a Federal grant. Office rent or general accounting are good and obvious examples of joint or common costs that cannot be easily identified to a specific program. Personnel administration and office supplies are other examples of joint or common costs.[1]

It is imperative to treat cost consistently for all programs and activities of the organization. If a cost is treated as a direct cost for the Federal program, the same type of cost incurred for another program should be treated as a direct cost to that program. For example, if long distance telephone costs are direct charged to Federal Grant #1, long distance telephone costs of other programs should be classified as direct costs, and not included in the indirect cost pool. (However, long distance telephone cost associated with allowable administrative efforts can be classified as an indirect cost. See Footnote 1.)

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[1] All administrative costs could be classified as joint or common costs. However, some efforts which may be considered administrative by the organization, are not allowable or allocable to Federal programs. Functions such as fund raising, services to members and clients or services to the general public when significant and necessary to the mission of the organization, are not indirect costs allocable to Federal programs and must be classified as direct cost in accordance with OMB *Circular* A-122.

Local telephone cost would be very difficult to identify directly to a specific program without a lot of effort or without dedicating phones to specific programs, neither of which seems very practical. So, in most situations, all local telephone costs should be classified as indirect costs.

Thus, telephone cost is broken down between local and long distance. Since local telephone costs would be difficult and impractical to direct charge to all programs, all local telephone costs are classified as indirect and allocated to all programs - a consistent treatment. Long distance calls are identified to specific programs and administration where the calls were in support of allowable administrative efforts - also a consistent treatment. An analysis similar to the one done on telephone costs should be performed for each element of cost to determine direct/indirect classification.

3. Select the Allocation Base. After all costs have been classified as direct or indirect, the next step is to select the allocation base. The allocation base should provide a reasonable approximation of the benefits received by a program from the costs of the functions and services in the indirect cost pool. We prefer an allocation base of salaries and wages. Our experience has shown that most functions and services which comprise the cost in an indirect cost pool benefit people. Therefore, a base that is a factor of people, such as salaries and wages, usually is a fair and equitable base. Total direct cost bases tend to overallocate indirect costs to large dollar, non-personnel costs such as subcontracts and travel, while the functions and services in the indirect cost pool do not provide benefits to the same degree. This does not mean that other bases may not be used. If a base other than salaries and wages is demonstrated by the organization to be more equitable, that base may be used.

4. Calculate the Rate. The final step is to divide the indirect cost pool by the allocation base and the result is the indirect cost rate. Appendix 1 is a detailed example of a suggested method for computing an indirect cost rate. It is only an example and not a prescribed method. Your proposal should fit your accounting system. However, this method will fit most situations and provide an excellent means to compute an indirect cost rate.

SECTION III - Submission of an Indirect Cost Proposal

General

The indirect cost proposal, or evidence that the proposal was approved by a Federal agency, should be submitted with the grant application. An indirect cost proposal documents how the organization develops and applies its indirect cost rate. All claims for indirect costs must be supported by an indirect cost rate proposal. Organizations that do not prepare indirect cost proposals risk losing their claims for indirect costs. The indirect cost rate proposal will be used to establish a rate for funding indirect costs under the grant. Guidelines on the preparation of an indirect cost proposal are provided in Section II.

Supporting Documentation

The estimated indirect costs and allocation base must be supported by either the accounting history (actual costs), budgeted costs, or a combination of both. If the estimated indirect costs are based on actual costs for the most recently completed fiscal year, the proposal must be accompanied by, and be cross-referenced and reconciled to, the organization's audited financial statements which account for all activities. When audited financial statements are not available, the organization should use the accounting records. If the estimated indirect costs are based on the organization's budget, the budget and financial statement for the most recently completed fiscal year must be submitted with the proposal.

In addition, the indirect cost rate proposal must contain a certification by an authorized organization official that the proposal has been prepared in accordance with Office of Management and Budget Circular A-122 (see Appendix 5).

Appendix 2 contains a detailed list of the information and documentation that should be submitted with an indirect cost rate proposal.

SAMPLE INDIRECT COST PROPOSAL FORMAT

TOTAL EXPENDITURES FOR THE ORGANIZATION

		DIRECT COSTS										
	Total Costs	Program No. 1	Program No. 2	Program No. 3	Program No. 4	Federal Grant 1	Federal Grant 2	Federal Grant 3	Fund Raising Note 8	Total Direct	Total Indirect Costs	Note*
Elements of Cost:												
Salaries & Wages	$1,000,000	$125,000	$100,000	$50,000	$75,000	$50,000	$100,000	$200,000	$50,000	$750,000 A	$250,000	2
Fringe Benefits	300,000										300,000	3
Office Rental	100,000										100,000	4
Repairs & Maint.	25,000										25,000	4
Materials	18,000	1,000	1,500	1,000	5,000	2,000	1,000	3,000	1,500	16,000	2,000	5
Supplies	15,000										15,000	4
Telephone	8,500	500	1,000			500	1,000	500	2,000	5,500	3,000	6
Professional Serv.	51,000	2,000	5,000	10,000	5,000	2,000	10,000	5,000	10,000	49,000	2,000	5
Subcontract	160,000	50,000	25,000		30,000	20,000	10,000	15,000	10,000	160,000		5
Interest	5,000										5,000	7
Bad Debt	2,000										2,000	7
Entertainment Expense	3,000										3,000	7
Fines and Penalties	2,000										2,000	7
Donations	4,000										4,000	7
Depreciation	10,000										10,000	9
Other Expenses	5,000										5,000	
Total Costs	$1,708,500	$178,500	$132,500	$61,000	$115,000	$74,500	$122,000	$223,500	$73,500	$980,500	$728,000	1
Less Indirect Cost Adjustment:												
Interest											5,000	7
Bad Debt											2,000	7
Entertainment Expense											3,000	7
Fines and Penalties											2,000	7
Donations											4,000	7
Public Information											2,000	7
Total Indirect Costs										B	$710,000	

The allocation base for total allowable indirect costs (B) is total direct salaries and wages (A).
Computation of indirect cost rate of 94.7% is $710,000 (B) divided by $750,000 (A).
* The notes on the following pages give detailed information of the items.

Notes:

1. For this example, the amounts are taken from the organization's independently audited financial statements. Expenditures reflect the purpose for which costs shown under total expenditures were incurred. They may be identified from (a) the Statement of Functional Expenses which is frequently included with the financial statements, (b) the accounting records maintained by the organization, or (c) an analysis of the costs in relation to the operation of the organization.

2. Salaries and wages, whether treated as direct costs or indirect costs, will be based on documented payrolls approved by a responsible official of the organization. The distribution of salaries and wages to Federal grants must be supported by personnel activity reports, such as time sheets, to account for all actual work performed for which the employees are compensated. Also, indirect salaries and wages must be supported by personnel activity reports where the employees performed a combination of indirect cost and direct cost activities. Salaries and wages for employees performing all indirect cost activities, such as administration, accounting, etc., are classified as indirect costs. For example, no accounting costs will be treated as direct costs to grants or other activities since these costs are treated as indirect costs.

3. Fringe benefits paid by an organization for their employees could consist of paid vacations, holidays and sick leave, health and life insurance, FICA, workmen's compensation, and retirement. Fringe benefits, in this illustration, are all treated as indirect cost. However, fringe benefits may be allocated based on a fringe benefit rate and distributed on the basis of salaries and wages (excluding costs for vacations, holidays and sick leave).

4. In this illustration, all costs for office rental, repairs and maintenance, and supplies are classified as indirect costs.

5. Specific identification (e.g., requisitions, purchase orders) procedures are used as the basis for charging these costs to benefiting activities (including Federal grants).

6. The cost of long distance calls are charged directly to benefiting activities (projects/programs, Federal grants, and indirect functions). When any costs for long distance calls are specifically identified as direct costs to Federal grants, all other costs for long distance calls would not be classified as indirect costs since this would be an inconsistent treatment of costs. Therefore, if the cost of long distance call are identified as direct costs to Federal grants, all other costs for long distance calls must be specifically

Notes:

identified to other projects/programs and indirect functions to be consistent in the treatment of costs. If records are not maintained for identifying the direct costs, the total costs for all long distance calls would be classified as indirect. Cost of local calls and monthly service charges are classified as indirect costs.

7. These adjustments eliminate unallowable costs identified in OMB Circular A-122 from the indirect cost pool. Examples of unallowable costs include interest expense, entertainment expense, lobbying, bad debts or allowances for doubtful accounts, fines and penalties, losses on Federal or non-Federal projects, provisions for contingencies, and charitable contributions.

8. Includes labor, fringe benefits and other costs associated with fund raising, public relations and maintenance of membership rolls. These types of costs are not allocable to Federal programs and must be classified as direct costs in accordance with OMB Circular A-122.

9. Only current expenditures should be considered in developing indirect cost rates. Therefore, capital expenditures (e.g., alteration and improvement costs) should be removed from the indirect cost pool. However, the organization may include depreciation or use allowance associated with those assets in accordance with Circular A-122.

INFORMATION/DOCUMENTATION NEEDED FROM THE NONPROFIT ORGANIZATION

The nonprofit organization will need to submit the following information or documentation to support the indirect cost rate proposed:

1. A copy of the organization's most recently audited financial statements if this is the basis for the indirect cost rate proposal along with a reconciliation of the proposal to the audited financial statements, in total and by cost center.

2. A copy of the organization's fiscal year budget if this is the basis for the indirect cost rate proposal along with a reconciliation of the proposal to the budget. A copy of the most recently audited financial statements may be requested for EPA's evaluation of the budget.

3. A list of grants active during the indirect cost rate proposal period and a copy of the budget data for the grant application. The grants should be identified by purpose, amount, period covered and numbers assigned by the Federal agency. Indicate if the grants provide for payment of indirect costs.

4. A schedule of indirect salaries. The schedule should include job title, amount and brief description of duties. Some salaries may need to be allocated between direct and indirect activities. The amount allocated to each activity or function should be identified along with description of the direct and indirect duties, shown separately, should be provided.

5. A schedule of fringe benefits and payroll taxes by type and amount. Explain the method by which fringe benefits are charge/allocated to activities (project/programs, Federal grants, and indirect functions).

6. A certification by an authorized organization official that the indirect cost proposal has been prepared in accordance with Office of Management and Budget Circular A-122 (see Appendix 5).

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

May 19, 1987

M-87-24

CIRCULAR NO. A-122, Revised
Transmittal Memorandum No. 2

TO THE HEADS OF EXECUTIVE DEPARTMENTS AND AGENCIES

SUBJECT: Cost Principles for Nonprofit Organizations

This memorandum revises OMB Circular A-122, "Cost Principles for Nonprofit Organizations, to clarify requirements for maintenance and access to records for costs associated with legislative lobbying and political activities.

In attachment B, section B21, "Lobbying," paragraph c.(4) is revised as follows:

> c.(4) Time logs, calendars, or similar records shall not be required to be created for purposes of complying with this section during any particular calendar month when: (1) the employee engages in lobbying (as defined in paragraphs (a) and (b) above) 25 percent or less of the employee's compensated hours of employment during that calendar month, and (2) within the preceding five-year period, the organization has not materially misstated allowable or unallowable costs of any nature, including legislative lobbying costs. When conditions (1) and (2) above are met, organizations are not required to establish records to support the allowability of claimed costs in addition to records already required or maintained. Also, when conditions (1) and (2) above are met, the absence of time logs, calendars, or similar records will not serve as a basis for disallowing costs by contesting estimates of lobbying time spent by employees during a calendar month.

James C. Miller III
Director

federal register

Friday
April 27, 1984

Part VII

Office of Management and Budget

Circular A-122: Cost Principles for Nonprofit Organizations; "Lobbying" Revision

Department of Defense
General Services Administration
National Aeronautics and Space Administration

48 CFR Part 31
Federal Acquisition Regulation; Final Rule

OFFICE OF MANAGEMENT AND BUDGET

Circular A-122; Cost Principles for Nonprofit Organizations—"Lobbying" Revision

[NOTE: This reprint incorporates corrections that are published in the Federal Register of Tuesday, May 8, 1984.]

AGENCY: Office of Management and Budget, Executive Office of the President.

ACTION: Publication of Revision to the Circular.

SUMMARY: This notice sets forth the final version of the Office of Management and Budget's (OMB) "Lobbying" revision to Circular A-122, "Cost Principles for Nonprofit Organizations." The revison makes unallowable for Federal reimbursement the costs associated with most kinds of lobbying and political activities, but does not restrict lobbying or political activities paid for with non-Federal funds.

A parallel revision is being made to the Federal Acquisition Regulation (FAR) to cover all defense and civilian contractors. The FAR revision appears on the pages immediately following the Circular A-122 revision.

EFFECTIVE DATE: This revision will become effective May 29, 1984. The revision will affect only grants, contracts, and other agreements entered into after the effective date. Existing grants, contracts, and other agreements will not be affected. Agency contracts and regulations will incorporate these provisions to the same extent and in the same manner as they do other provisions of Circular A-122.

FOR FURTHER INFORMATION CONTACT: John J. Lordan, Financial Management Branch, Office of Management and Budget, Washington, D.C. 20503, (202) 395-6823.

SUPPLEMENTARY INFORMATION: The attached text sets forth the final language for the revision to Circular A-122 that was proposed on November 3, 1983, 48 FR 50880-50874. Significant modifications have been made to the proposed language after a thorough review of the approximately 93,600 public comments received and extensive discussions with the General Accounting Office and cognizant Congressional committees.

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I. Background of Circular A-122

Circular A-122, "Cost Principles for Nonprofit Organizations," establishes uniform rules for determining the costs of grants, contracts, and other agreements. Like other OMB cost principle circulars for state and local governments and educational institutions, Circular A-122 is a management directive addressed to the heads of Federal departments and agencies and constitutes the legal basis by which they define allowable and unallowable costs and how such costs are calculated.

Circular A-122 was first issued in June 1980. It was developed by an interagency team chosen from the major grant-making agencies and led by OMB. Before issuance, public comments were sought and received, and consultations were held with the General Accounting Office. The cost principles built upon accounting rules previously in use by Federal agencies in their dealings with nonprofit organizations. The Circular standardized and simplified those rules. In general, the Circular provides that, to be recovered from the Federal government, costs incurred by grantees and contractors must be necessary, reasonable, and related to the federally-sponsored activity. In addition, costs must be legal, proper, and consistent with the policies that govern the organization's other expenditures.

The disallowance of lobbying costs in this revision is comparable to the disallowance by Circular A-122 of other costs which are not reimbursed on grounds of public policy, such as advertising, fundraising expenses and entertainment. In each of these instances, a determination has been made that it would not be appropriate or cost-efficient to permit Federal tax dollars to be used for these purposes. In any event, it should be noted that lobbying costs are currently unallowable; as indicated throughout, this revision is intended to clarify and make more uniform the meaning and application of that bar.

II. History of the Revision

On January 24, 1983, OMB published a proposal to revise Circular A-122's treatment of the costs of lobbying activities by defining as unallowable the costs of advocacy activities performed by Federal nonprofit grantees and contractors with appropriated funds. 48 FR 3348-3351. Following publication, OMB received approximately 48,300 comments from the public, from nonprofit and commercial organizations and from government agencies. Approximately 16,500 comments opposed the proposed revision, and approximately 31,800 supported it. Many of the comments opposing the revision expressed support for the general principle that Federal tax dollars should not be used for lobbying and related purposes, but objected that the proposals contained in the January 1983 notice would disrupt the legitimate activities of Federal nonprofit grantees and contractors. On the other hand, many of the supporting comments suggested a need for controls significantly more restrictive than those proposed.

In order to permit further study of the issues raised by these comments, OMB withdrew the January 1983 proposal at the end of the 45-day public comment period. In the intervening months, OMB conducted numerous discussions with nonprofit organizations, business groups, trade associations, the General Accounting Office, and interested Committees of the Congress and their staffs. After further consideration of the comments and discussions, OMB published a second proposal on November 3, 1983, to revise the Circular's cost standards. The November proposal represented a fundamental revision of the original January proposal as a result of the

lengthy dialogue between OMB and affected groups.

The most important changes from the January proposal were:

- Adoption of an allocation method of accounting for the costs of lobbying and related activities;
- A more limited definition of unallowable costs; and
- Clarifications and limits on reporting and recordkeeping requirements in the spirit of the Paperwork Reduction Act.

The November 1983 proposal initially provided for a 45-day public comment period. 48 FR 50860–50874. As a result of the interest shown by the public and Congress and the large volume of comments received by OMB, the comment period was extended for thirty days until January 18, 1984. 48 FR 56463–56464.

By the end of the public comment period, OMB had received some 93,600 separate comments. Of these, some 87,500 (93.5%) favored the proposed revision without further changes; some 4,175 (4.5%) opposed the revision or sought further modifications; and some 1,925 (2.0%) did not clearly express either support or criticism. These totals include only individually mailed comments; bulk packages of letters, including form letters and petitions, were counted as single comments.

In finalizing the revision, OMB has carefully reviewed each of the comments received. The November proposal has been further amended in several significant respects, and the final version addresses many of the concerns raised by the critical comments. OMB also has conducted extensive discussions with interested members of Congress and their staffs, particularly members of the House Government Operations Committee and the Senate Subcommittee on Intergovernmental Relations. Prior to publication of the November proposal, OMB had met extensively with Committee staff to review their concerns, and several major modifications were made to the proposal to accommodate their suggestions. OMB has continued to meet with the Committee staffs during the public comment period and, following development of the final language of the revision, OMB has reviewed this language with the Committees on several occasions. In addition, OMB has met with the General Accounting Office at various stages of the process and is authorized to state that the Comptroller General believes that OMB has the clear legal authority to issue the Circular amendment published today, and that he supports it.

III. Summary of the Revision

The revision amends Circular A–122 to define certain lobbying activities by nonprofit Federal grantees and contractors as unallowable costs which cannot be paid for with Federal funds. The most significant provisions make costs of the following activities unallowable:

- Federal, state or local electioneering and support of such entities as campaign organizations and political action committees;
- Most direct lobbying of Congress and, with the exceptions noted below, state legislatures, to influence legislation;
- Lobbying of the Executive Branch in connection with decisions to sign or veto enrolled legislation;
- Efforts to utilizie state or local officials to lobby Congress or state legislatures;
- Grassroots lobbying concerning either Federal or state legislation; and
- Legislative liaison activities in support of unallowable lobbying activities.

The revision is considerably less encompassing than the earlier proposals and the current regulations of other agencies governing for-profit contractors, in that it does not cover:

- Lobbying at the local level (unallowable under both the Federal Acquisition Regulation (FAR) and the Defense Acquisition Regulation (DAR) supplement to the FAR);
- Lobbying to influence state legislation, in order to directly reduce the cost of performing the grant or contract, or to avoid impairing the organization's authority to do so (covered under the current FAR, DAR supplement, and the January 1983 proposal);
- Lobbying in the form of a technical and factual presentation to Congress or state legislatures, at their request (unallowable under the current DAR supplement to the FAR);
- Contacts with Executive Branch officials other than lobbying for the veto or signing of enrolled bills (covered under the January 1983 proposal); and
- Lobbying on regulatory actions (covered under the January 1983 proposal).

In particular, the revision will make unallowable only the portion of costs attributable to lobbying (the "allocation" approach)—not, as in the January 1983 proposal, entire cost items used in part for political advocacy (the so-called "tainting" approach).

The revision will provide relief from paperwork and audit burdens for nonprofit organizations (and, under a simultaneous change being made in the FAR, for government contractors). For example, indirect cost employees (such as executive directors) will not be required to maintain time logs or calendars (for the portion of their time treated as an indirect cost) if they certify in good faith that they spend less than 25% of their work time in defined lobbying activities. Moreover, the clear standards provided by the revision will prove of substantial benefit to nonprofit grantees in audit situations by reducing the resources necessary to resolve whether Federal funds were spent on unallowable activities.

The penalties for violating the revision will be the same as for any other cost principle in OMB Circular A–122. The standard remedy is recovery of the misspent money. In cases of serious abuse, however, the grant or contract may be suspended or terminated, or the recipient may be debarred from receiving further Federal grants or contracts for a certain period.

IV. Significant Changes From the November Proposal

After review of the comments submitted during the comment period, OMB has made further significant changes to the revision. Among the most noteworthy amendments are the following:

1. *The definitional term "lobbying and related activities" has been changed to "lobbying."*

Numerous commenters expressed concern that the term "related activities" could be used in the future to expand the scope of unallowable activities beyond what is explicitly defined as unallowable. This was not OMB's intent, which was merely to use the most appropriate term for describing the unallowable activities, which include electioneering and activities supporting unallowable lobbying, as well as what is normally thought of as "lobbying."

The original term for the activities defined as unallowable (in the January 1983 proposal) was "political advocacy." That term was changed to "lobbying and related activities" in the November proposal and has now been revised to "lobbying." Deletion of the term "related activities" does not affect the continuing disallowance of "costs associated with" unallowable lobbying—including those activities undertaken to facilitate that lobbying.

2. *The restrictions on direct legislative lobbying and grassroots lobbying have been clarified to cover attempts to influence "the introduction of legislation" and "the enactment or*

*modification of * * * pending legislation."* Sections a(3) and a(4).

This change makes more precise the scope of the activities disallowed, and conforms to the IRS definition of lobbying.

3. *The "legislative liaison" provision has been made less restrictive, and clarified.* Section a(5).

In the November proposal, all legislative liaison was deemed to be unallowable unless it did not relate to otherwise unallowable activities. Commenters complained that this section was both too confusing, because it employed a double negative, and too restrictive. Section a(5) has been revised to clarify that legislative liaison is unallowable only "when such activities are carried on in support of or in knowing preparation for an effort to engage in unallowable lobbying," as defined in the revision.

4. *The exception for providing assistance in response to a "specific written request" has been broadened to facilitate easier usage and has been narrowed in other respects.* Section b(1).

The final version has been broadened by deleting the "specific written request" requirement and permitting oral requests, if properly documented; allowing "cognizant staff members" (in addition to Congressmen) to make such requests; and making *Congressional Record* notices sufficient to invoke the exception.

The exception also has been narrowed in certain respects by limiting it to information derived from grant or contract performance that is conveyed in "hearing testimony, statements or letters" and requested by legislative sources; requiring presentations to be "technical and factual," and further requiring that the information is "readily obtainable and can be readily put in deliverable form." Further, the use of the term "technical and factual presentation" avoids use of the exception whenever technical and factual information is provided in any manner of lobbying presentation and likewise avoids the requirement that brief advocacy conclusions following technical and factual presentations require separate accountings and disallowances.

The costs of travel, lodging or meals involved in lobbying activities which would otherwise be unallowable under the terms of section a(3) are nonetheless made allowable if expended for the purpose of offering Congressional hearing testimony pursuant to written request of the Committee's Chairman or Ranking Minority Member for a technical and factual presentation.

5. *The state waiver clause in the state lobbying exception has been deleted and the scope of the exception clarified.* Section b(2).

The state waiver clause was added to the November 1983 notice in response to concerns raised by some nonprofit organizations. It would have permitted states to make allowable all state lobbying by their subgrantees. Upon further review, however, the clause was determined to be confusing and superfluous. Further, under none of Circular A-122's other 50 cost categories do states have the right to override Federal cost standards.

Two significant clarifying changes have been made in new section b(2). First, the "lobbying" covered by the exception has been explicitly limited to lobbying made unallowable by section a(3); thus, for example, grassroots lobbying (covered under section a(4)) does not come within the exception. Second, the exception has been reworded to apply to efforts to influence state legislation affecting an organization's authority to perform a grant, contract, or other agreement, and efforts to reduce the costs to the organization of such performance. The original language, applying to an organization's "ability" to perform the grant, contract, or other agreement, was deemed too broad.

6. *The exception for "activity in connection with an employee's service as an elected or appointed official or member of a governmental advisory board" was deleted.* Section c(3) in November proposal.

This provision was put in the January 1983 proposal to prevent part-time government officials from being subject to complete non-reimbursement as a result of the "tainting" principle. Since the allocation method is now used, the exception is irrelevant and would open major loopholes.

7. *The "disclosure" requirement relating to the indirect cost rate proposal has been clarified and explicitly tied to existing accounting guidelines.* Section c(1).

The November proposal had required a statement "identifying by category, costs attributable in whole or in part to lobbying" and "stating how they are accounted for."

Section c(1) now simply requires that total lobbying costs "be separately identified" in the indirect cost rate proposal and treated consistently with other unallowable activity costs, as required by the operative Circular A-122 accounting provision.

8. *The Circular A-122 certification requirement has been changed to conform to the Defense and GSA November 1983 proposal.* Section c(2).

The November proposal's certification requirement pertains to the "Financial Status Report," which is prepared on an individual grant basis. However, most lobbying activities are accounted for in an entity's indirect costs, which are calculated on an organization-wide basis. Thus, the appropriate place to certify such costs is in the Indirect Cost Rate Proposal, as required under the Defense and GSA (FAR) approach. The final version has been changed to reflect this fact.

9. *The language explaining the "25% Rule" exception for recordkeeping has been clarified.* Section c(4).

Some commenters said that the annual period the 25% rule covered created retroactivity problems, in that intensive late-year lobbying could remove the rule's paperwork provisions for persons who had previously estimated that the 25% trigger would not be exceeded. Other commenters said it was unclear whether the rule was to be based on 40-hour weeks or the actual hours worked. In response, the phrase "25% of the time" has been revised to "25% of his compensated hours of employment during that calendar month."

V. Purpose of the Revision

As set forth at greater length in the preambles to the January and November notices, the purpose of this revision is to establish comprehensive, government-wide cost principles to ensure that nonprofit Federal grantees and contractors do not use appropriated funds for lobbying activities. This principle is achieved by disallowing the recovery of lobbying costs in a manner consistent with the treatment under Circular A-122 of other costs which are disallowed on grounds of public policy. In adopting this revision, OMB does not intend to discourage or penalize nonprofit organizations from conducting lobbying efforts with their own non-Federal funds. The sole purpose of this revision is to require that those efforts be paid for with funds raised from other sources and to ensure that the Federal government does not subsidize such lobbying activities with appropriated funds. In addition, this revision seeks, for the sake of auditors and auditees both, to clarify definitions and thereby to make the current provisions against use of funds for lobbying purposes both easier to comply with and to enforce.

In recent years, Congress and the Comptroller General have recognized that the use of Federal monies by grantees and contractors to engage in

lobbying is inappropriate. The voluminous comments OMB received on the revision demonstrate that there is little disagreement on this score. Use of appropriated funds for lobbying diverts scarce resources from the purpose for which the grant or contract was awarded. By permitting such a use of its funds, the government subsidizes the lobbying efforts of its contractors and grantees. This improperly distorts the political process, by favoring the political expression of some—organizations with contracts or grants—relative to others, who must conduct their political expression at their own expense.

Government subsidization of certain participants the debate over legislative outcomes may contradict important principles of government neutrality in political debate, and use of Federal funds for private lobbying can give the appearance of Federal support of one political position over another. As the comments indicate, subsidizing such lobbying can create misunderstanding and interfere with the neutral, nonpartisan administration of Federally-funded programs. The revision seeks to avoid the appearance that, by awarding Federal grants, contracts, or other agreements to organizations engaged in political advocacy on particular sides of public issues, the government has endorsed, fostered, or "prescribe[d] [as] orthodox" a particular view on such issues. *West Virginia State Board of Education* v. *Barnette*, 319 U.S. 624, 645 (1943).

Requiring grantees and contractors to bear the costs of their own lobbying efforts does not infringe upon their constitutional rights. No person or group has a First Amendment right to receive government funding for political expression. As the Supreme Court has recently emphasized in a unanimous opinion, free speech does not mean subsidized speech. The Federal government "is not required by the First Amendment to subsidize lobbying. . . . We again reject the 'notion that the First Amendment rights are somehow not fully realized unless they are subsidized by the State.'" *Regan* v. *Taxation with Representation of Washington*, 103 S.Ct. 1997, 2001 (1983).

In recent years, the problem of the use of taxpayer funds for lobbying purposes has become of increasing concern, and steps have been taken in a variety of different contexts to address the problem. There has been increasing public concern that limited grant and contract resources should not be used in projects that involve political organizing.

Congress has responded to this problem by adopting numerous appropriations restrictions to address some of the more flagrant abuses and problems raised by lobbying activities with Federal funds. Indeed, over the past ten years, some 40–50 riders have been attached to appropriations bills to address different aspects of the problem. These appropriations riders use many different formulations, but have as a common element prohibiting the use of appropriated funds for publicity or propaganda purposes designed to support or defeat legislation. The agencies affected by specific appropriations riders include Defense, the District of Columbia, the Legal Services Corporation, and agencies covered by the State-Justice-Commerce Appropriations Acts. For example, the current Labor-HHS-Education-Related Agencies Appropriations Act, dealing with agencies that dispense the large proportion of grant funds, reads as follows:

> No part of any appropriation contained in this Act shall be used to pay the salary or expenses of any grant or contract recipient or agency acting for such recipient to engage in any activity designed to influence legislation or appropriations pending before the Congress. (Section 308, Pub. L. 98–139.)

This provision has been construed by the Justice Department to extend the ban on grantee activities significantly beyond the conduct of "grassroots" campaigns. Moreover, as to many of the appropriations riders which prohibit agencies from using public funds for their own lobying activities, clear policies regarding grantee and contractor expenditures for lobbying may be needed in order for the agencies not to be in violation, albeit indirect, of their statutory restrictions. Enforcement of these appropriations provisions, and of the consensus principle that Federal funds should not be used to support lobbying activities, has proved to be very difficult, because of the absence of any clear definitions or standards for determining which activities by grantees and contractors violate the lobbying restrictions.

Furthermore, when audits are undertaken, the lack of clear standards imposes substantial burdens on the grantees. Auditors can have great discretion and significant leverage over the grantees in negotiations to determine which factors should be included in allowable costs. If auditors decide to inquire into lobbying activities, nonprofit entities can be compelled to provide elaborate factual backup from their records to refute any claims that may be raised. In light of the enormous expansion of Inspector General staffs and the sensitivity of this issue, significantly more auditing activity can reasonably be expected in this area in the future. Accordingly, the current practices do not serve the current need to assure that Federal funds are not used for lobbying purposes and, as well, impose potentially heavy burdens on agencies, their auditors and the nonprofit entities themselves.

As the Investigations Subcommittee of the House Armed Services Committee recently concluded:

> [T]here is a deficiency in the appropriations acts' prohibition of lobbying with appropriated funds. A review of the legislative history of the publicity-propaganda appropriations acts restrictions provides no definition of the critical terms 'publicity' and 'propaganda.' Thus, there appears to be no firm distinction between the conduct which is permissible and that which is prohibited. Thus the clear signal from Congress through the appropriations laws and other actions has not been translated into effective management controls.

In the commercial field, several steps recently have been taken to facilitate the need to be sure that Federal funds are not used for lobbying. For example:

- On December 18, 1981, the Department of Defense issued revisions to its Defense Acquisition Regulation (DAR), addressing for the first time the issue of lobbying activities, and making certain such costs unallowable under Defense contracts.
- On April 27, 1982 and October 22, 1982, Defense further toughened its rules disallowing lobbying costs by eliminating certain exceptions from coverage.
- On May 28, 1982, NASA issued a new cost principle in the NASA Procurement Regulation (NASAPR) making certain lobbying costs unallowable for NASA contractors.
- On November 2, 1982, the General Services Administration issued a new cost principle in the Federal Procurement Regulation (FPR) making certain lobbying costs unallowable for civilian agency contracts with commercial organizations.
- On April 1, 1984, the three sets of cost principles that had governed Federal contracts—the DAR, FPR and NASAPR—were replaced by the new Federal Acquisition Regulation (FAR). The FAR is the product of several years of inter-agency negotiations to create a uniform set of guidelines for all Federal contractors. The procurement agencies are required to use the new FAR regulation except in those cases where they issue a formal deviation to a specified FAR section. The FAR adopted

the former FPR lobbying cost principle. The Defense Acquisition Regulation Council, however, issued a deviation so that the former DAR lobbying cost principle continues to be operative for Defense contractors.

These initiatives, however, affect only defense and civilian contracts with commercial entities. No generally applicable cost principle has been issued to cover the Federal funding of lobbying under contracts and grants to nonprofit organizations. These entities, however, are in the same position with respect to most Federal government cost guidelines as profit-making grantees and contractors, and the comments received by OMB clearly and overwhelmingly support the view that the same lobbying cost principles should likewise apply to them. Therefore, in keeping with sound management practices, it is important that the lobbying cost principles be extended to these nonprofit entities and harmonized, to the maximum extent practicable, with the principles already applicable to commercial concerns.

Given the vagueness of the existing A-122 standards, the need for a clear cost principle on lobbying for nonprofit grantees was addressed explicitly by the Comptroller General in September 1982, after a GAO investigation of whether funds under Title X of the Public Health Services Act were used to finance lobbying activities or abortion-related activities:

> Clear Federal guidance is needed both to ensure that Title X program funds are not used for lobbying and to preclude unnecessary controversy over whether grantees are violating Federal restrictions. *The move to revise and make more specific the cost principles applicable to all Federal grantees is the appropriate mechanism to achieve these ends.* GAO/HRD-82-106 (Sept. 24, 1982) at 27 (emphasis added).

This revision thus addresses the major area in which Federal cost principles have not yet been adopted to ensure that appropriated funds are not used to subsidize lobbying by Federal grantees and contractors. This revision is intended to provide lines of demarcation so that nonprofit entities can know in advance what is allowable. The revision protects their First Amendment rights and in significant respects strongly advances their interests. By giving nonprofit entities clear guidance and limiting the bookkeeping work that can be required to refute an auditor's claim of unallowable costs, the revision removes a potentially severe burden from these entities, especially the smaller and less well financed groups. In addition, although the revision cannot resolve in advance every problem which may arise in this complex field, a mechanism has been provided by which nonprofits may obtain advance rulings whether certain costs are unallowable.

The revision is similar in critical respects to the current Defense and FAR procurement regulations, although—as noted elsewhere in this preamble—provisions added in the past two years to the cost principles governing all Federal contractors are far more restrictive than the revision adoped here. Since parallel revisions are being issued for Circular A-122 and FAR sets of cost principles, the present initiative guarantees uniformity of lobbying cost rules for both nonprofit and profit-making recipients of Federal funds. This principle of uniformity has been urged by Congressional commenters and by the GAO.

VI. Principal Objections to the Proposal

A. Legal Authority

Numerous commenters suggested that OMB lacks authority to issue this revision to Circular A-122. Most of these comments appear to have been based upon a report of the Congressional Research Service, which suggested that this might be a potential legal issue but ultimately reached no conclusion on the matter. OMB, supported by the Comptroller General, believes that its legal authority to issue the amendment is clear.

The responsibility for implementing grant programs, including the power of administration, has been delegated by Congress to the various grant- and contract-making agencies. It has long been settled that the Federal government may impose terms and conditions upon grants and contracts it awards, including those given to State or local government instrumentalities. *See, e.g., King* v. *Smith*, 392 U.S. 309 (1968). Accordingly, those agencies have the direct legal authority to establish cost principles and, prior to the late 1970s, did so in a piecemeal fashion without coordinated government-wide standards.

OMB's legal authority for establishing cost principles derives from the President's constitutional authority to "take care that the laws be faithfully executed," U.S. Constitution, Article II, Section 3; his authority under section 205(a) of the Federal Property and Administrative Services Act, 40 U.S.C. 486(a); and from the general supervisory responsibilities over the Executive Branch vested by Congress in the President and in OMB. In particular, in its capacity as the President's managing agent for the Executive Branch, OMB is authorized by 31 U.S.C. 1111(2) to assist the President in improving economy and efficiency throughout the government by developing plans for the improved organization, coordination, and management of the Executive Branch. This revision constitutes an effort to develop government-wide cost principles that are uniform, to the maximum extent practicable, and treat similarly situated organizations alike.

The President assigned responsibility for grants management to OMB by Executive Order No. 11541 (July 1, 1970), pursuant to Reorganization Plan No. 2 of 1970, 5 U.S.C. App. Subsequently, grants management authority was transferred to GSA by Executive Order No. 11717 (May 9, 1973) and transferred back to OMB by Executive Order No. 11893 (December 31, 1975). Relevant statutory authorities include section 209 of the Budget and Accounting Act of 1921, 31 U.S.C. 1111(1); and section 104 of the Budget and Accounting Procedures Act of 1950, 31 U.S.C. 1111(2). Under these and other general management authorities, OMB may develop plans for implementing better management with "a view to efficient and economical service" and may issue supplementary interpretative guidelines "to promote consistent and efficient use of procurement contracts, grant agreements, and cooperative agreements."

In its capacity of exercising the President's general management functions over the Executive Branch, OMB has the power to supervise and direct the management activities of Federal agencies. OMB has issued a series of Circulars over the years in discharging these delegated responsibilities, and these Circulars serve as one of the primary means of informing the agencies how to exercise their authority in administrative and managerial matters. The cost principles set forth in Circular A-122 exemplify OMB's traditional budget and management policy authority.

OMB Circulars are binding upon the Executive agencies as a matter of Presidential policy. Agencies, in turn, incorporate the provisions and requirements of applicable OMB Circulars into grant and contract agreements through regulations, grant or contract terms, or other means. In this manner, the Circular provisions become legally binding upon contractors and grantees. Indeed, provisions of OMB Circulars have been held legally applicable to grantees even when the grant-making agency has not explicitly implemented the Circular. *Qonaar Corporation* v. *Metropolitan Atlanta Rapid Transit Authority*, 441 F. Supp. 1168, 1172 (N.D. Ga. 1977).

This revision, like the cost principles disallowing advertising, fundraising, entertainment, and investment management costs, is directly related to the efficient and economical administration of grants, contracts, and other agreements. By prohibiting the use of grant and contract monies for lobbying (unless specifically authorized by statute), funds can be directed toward their proper uses, thereby achieving greater public benefit. As the Comptroller General has noted, "The cost principles applicable to all Federal grantees is the appropriate mechanism to achieve these ends [of ensuring that program funds are not used for lobbying]." GAO/HRD-82-106 (September 24, 1982), at 27.

As noted, the Comptroller General believes that OMB has the clear legal authority to issue the Circular amendment published today, and supports it.

B. First Amendment Considerations

Some commenters suggested that the revision might, under certain circumstances, be construed as imposing unconstitutional burdens on First Amendment freedoms of speech, association, and the right to petition Congress. Most of these objections appear to follow, in large measure, an analysis of the proposed revision prepared by the Congressional Research Service (CRS) which, as indicated, noted that constitutional questions might be raised but ultimately did not conclude that the proposal was unconstitutional in any respect. Constitutional objections to the revised November proposal were sharply reduced, apparently in response to the May 1983 decision of the Supreme Court in *Regan* v. *Taxation With Representation of Washington*, 103 S. Ct. 1997. That case reemphasized that nonprofit entities do not have a First Amendment right to have their political advocacy activities subsidized by the Federal government and essentially satisfies the principal constitutional concerns raised during the comment period. OMB, however, has carefully reviewed the comments and, where improvements in phrasing could be made to eliminate ambiguity or provide clarity, appropriate changes have been made.

Intent Underlying the Circular. Some commenters suggested that the revision was the product of an unconstitutional discriminatory purpose, an alleged intent to "defund the left." Assuming, *arguendo*, that the allegation is relevant as a matter of law in overriding the actual effect of the revision, this concern is without foundation. As more fully explained in the November 1983 notice, the intent behind the revision is nondiscriminatory, and its effects are politically neutral. It is designed, as a matter of sound management practice, to extend to nonprofit grantees and contractors a cost reimbursement policy already applicable to similarly situated profit-making entities. The revision is intended only to ensure that Federal funds are not used to subsidize lobbying efforts. The revision is content neutral and is not intended "to discourage or in any way penalize organizations for lobbying efforts conducted with their own funds." 48 FR at 50860. Furthermore, nothing in these neutral accounting principles provides any basis for concern that they will be applied in anything but an impartial, objective fashion. Accordingly, the revision passes constitutional muster. *Regan* v. *Taxation With Representation of Washington*, 103 S. Ct. 1997, 2002–2003.

Overbreadth. Some commenters claimed that the revision violates the First Amendment because its provisions are overbroad and not drafted "precisely" and "narrowly" enough. For example, the League of Women Voters expressed concern that the language of the revision somehow might require "disclosures concerning the source of funds for private lobbying and certain other political activities," in violation of its freedom of association and right of privacy.

Upon review of the comments, OMB believes that the "overbreadth" claims are defective. This is particularly so in light of the elimination of the so-called "tainting" theory, under which Federal reimbursement would have been disallowed for the entire cost of any supplies, equipment, or services of a nonprofit organization used even partially for lobbying or advocacy activities. The November proposal and this final version have dropped the "tainting" approach in favor of a much more narrowly crafted "allocation" approach, in which only the actual amounts expended are deemed unallowable—an amendment that more than satisfies all overbreadth concerns. Moreover, this allegation applies with greater force to the current, vague bar in the Circular and to the statutory bars earlier noted.

Vagueness. Other commenters suggested that the proposed revision was impermissibly vague. For example, the National Education Association contended that "the revised proposal is so ambiguous and vague that organizations would not know how to comply with them and OMB could interpret them arbitrarily and apply them unequally," and the American Friends Service Committee alleged that "[t]his [proposal] will tend to chill advocacy efforts of organizations for fear of jeopardizing Federal grants and contracts." Some commenters, including the League of Women Voters, also claimed that the proposal leaves nonprofits with no better guidance on unallowable costs than before.

Upon review of the comments, OMB finds these claims wholly unpersuasive. As noted above, the management consideration driving this revision is the desire to provide a clear, uniform definition of unallowable activities, so that grantees and contractors will know what is expected of them and can conform their conduct to the guidelines, and so that agencies and auditors will have more explicit standards to which to refer than are now available. The suggestions about vagueness are wholly speculative and without any real basis. However, in order to avoid any possible ambiguity and provide explicit guidance to nonprofit entities, the final revision has been revised in several respects, and a section-by-section explanation of the operation of the revision provided. In particular, as described in detail below, the proposed definitional phrase "lobbying and related activities" has been changed to "lobbying," and the standard "costs associated with" term has been used to clarify application of subparagraphs a and b. Finally, section (c)(5) of the proposal provides for advance clarification procedures between agencies and grantees, which should further assist in the development of a fair evolutionary process of implementing the final revision and its objective of limiting Federal subsidization of lobbying.

Recordkeeping. Finally, some commenters suggested that the revision's reporting and recordkeeping requirements somehow would burden or chill the First Amendment rights of nonprofit entities. These recordkeeping requirements comply fully, however, with the Supreme Court's decision in *Regan*, *see* 103 S. Ct. at 2000 n.6, and are consistent with accepted accounting principles. In fact, they constitute one of the major factors which eliminates any alleged potential for "unfettered administrative discretion" about which other commenters, notably CRS, objected. These requirements have been intentionally made *less* onerous and far more explicit than those provided by OMB management circulars in other circumstances for other types of costs. *See* the current Circular A–122, and Circular A–110: "Uniform Administrative Requirements" for nonprofit organizations, and compare

with section c(4) of the revision. As noted above, one of OMB's primary goals has been to reduce the burden on nonprofit entities during the audit process and to reduce the amount of bookkeeping material auditors may demand in challenging the allowability of their lobbying costs.

The revision simply requires nonprofit entities to "maintain adequate records to demonstrate that the determination of costs as being allowable or unallowable pursuant to paragraph B21 complies with the requirements of this Circular." The paragraph does not call for separate establishment of the lobbying and non-lobbying activities of an entity. Indeed, in the case of indirect-cost employees who spend 25% or less of their time engaging in lobbying, there is no requirement that they maintain time logs, calendars, or similar records. The grantee or contractor, in such instances, exercises full discretion over its recordkeeping activities.

In sum, the recordkeeping requirements are lawful, reasonable, and by no means burdensome relative to other unallowable cost activities.

C. Relationship With Internal Revenue Code Provisions

Some commenters suggested that the Circular A-122 revision was not necessary because the Internal Revenue Code's restrictions regarding "influencing legislation" by 501(c)(3) organizations already provide sufficient protection against lobbying abuse. Others claimed that the revision could create confusion or needlessly increase the paperwork burden on grantees and contractors already regulated by the Code provisions. Neither of these arguments is valid.

The lobbying restrictions of the Internal Revenue Code and Circular A-122 serve entirely different functions. The Code has no direct bearing on preventing the use of grantee funds for lobbying purposes, because it governs only the use of private funds and does not concern the use of Federal monies. The sole purpose of the Code provisions is to define the character and status of organizations that will be entitled to favorable tax treatment. As long as lobbying expenditures do not exceed a certain portion of its revenues, an organization is eligible for tax-exempt status under the Code (assuming it also meets the qualifying tests in other areas). The Code's lobbying provisions determine only whether an organization is sufficiently devoted to a public purpose to justify preferential tax treatment.

The Code does not address the distinct question of whether Federal grant monies should be used to reimburse lobbying costs—the sole problem addressed by the Circular A-122 cost standards. The Code's lobbying provisions thus do not preempt or otherwise make unnecessary the promulgation of cost standards in this area. Indeed, the fact that the Code's lobbying provisions do not address the use of grant monies for lobbying has been implicitly recognized by Congress on numerous occasions through appropriation bill riders prohibiting such expenditures. *See, e.g.*, Pub. L. 97-377, section 509; Pub. L. 98-74, section 807.

The fact that certain expenditures by nonprofit organizations are lawful under the Code does not mean that Federal grant monies should be spent for those purposes. For example, the Code does not prohibit tax-exempt organizations from spending their revenues on advertising or entertainment. Circular A-122, however, allows only certain advertising costs, and disallows all entertainment costs, from reimbursement from Federal awards. Moreover, the Code does not preclude additional conditions from being imposed on tax-exempt organizations. For example, Section 503 of the Code denies tax-exempt status in certain instances to organizations using their revenues for the private gain of controlling individuals. That provision does not prevent disallowance of the use of Federal grant monies for the advancement of private partisan or financial interests. This point is perhaps best highlighted by the fact that nothing in the Code would prevent some grantees from spending all of their grant funds for lobbying purposes.

Similarly, the fact that the Code and other provisions of law regulate lobbying activities of business firms (*e.g.*, 26 U.S.C. 162(e); Federal Election Campaign Act, 2 U.S.C. 431-456) does not mean that there should be no provisions in the FAR regarding such activities. Some members of the business community suggested that any provisions in Circular A-122 regarding the unallowability of lobbying expenditures should be superseded by definitions of lobbying set forth in the Federal Regulation of Lobbying Act, 2 U.S.C. 261-270. The commenters have cited no authority, however, to support the view that the Code, lobbyist registration laws, or any other statutes obviate the propriety of the government's assuring that Federal grant and contract funds are spent only for authorized purposes and, to the degree feasible, that they be used to provide direct goods and services to intended beneficiaries.

Although the Code and Circular A-122 lobbying provisions serve different purposes, in practice the information and accounting practices necessary to satisfy these two authorities largely overlap so that it will generally be possible for both provisions to operate harmoniously. The Code provides a set of operational principles with which nonprofit organizations are already familiar. Thus, wherever possible, the final revision brings Circular A-122 into greater conformity with those sections of the Code dealing with nonprofit entities. Where differences remain, Circular A-122 is generally narrower in its application than the Code—and often far narrower. Thus, nonprofit entities should be able to adhere to the lobbying cost standard using existing accounting and bookkeeping systems.

While some commenters argued that Circular A-122 as revised would require all nonprofits to maintain multiple sets of books, no commenter was able to specify why simultaneous compliance with the Code and A-122 required such double recordkeeping. As discussed in the section concerning Paperwork Reduction Act considerations, a nonprofit organization maintaining adequate financial records should be able to comply fully with information requests from the Internal Revenue Service or its granting Federal agency. Further, section c(4) of the revision effectively exempts almost all employees (those that spend less than 25% of their time on unallowable lobbying activities) from any requirements to keep time logs, calendars, or similar records relating to indirect cost time.

D. Restricting the Flow of Information

Many of the critical nonprofit commenters asserted that it is crucial for them to be allowed to "educate" policymakers on pending legislation, and that the revision will impede their testimony and other assistance to legislators, by restricting the use of Federal grant and contract funds for lobbying activities. The National Education Association, for example, alleged that "the proposed revisions would have an adverse effect on the government and on nonprofit organizations through discouraging communication with Congress and disallowing activities that are vitally important to nonprofit organizations." Most such commenters seemed to premise their comments on the ground that the proposal would prevent them from even attending legislative hearings or analyzing legislation. Others claimed that, should Federal funds not be

available, there would be no other manner in which legislators could receive their valuable information.

OMB has repeatedly stated that the only effect of the revision is intended to prevent *Federal funds* being expended for lobbying purposes, and that nothing in the revision limits the ability of nonprofit entities to lobby with their own funds. OMB has made every effort to clarify the terms of the revision so as to eliminate such misconceptions about the scope of what is unallowable. Hence, various language changes have been made in the revision, especially in sections a(5) and b(1). It was never intended, for example, that funding for all attendance at legislative hearings would be proscribed, but only that that funding for attendance connected with or in knowing preparation for a lobbying effort would be precluded. The final version removes any doubt on this score.

The revision will not restrict the legitimate flow of factual information requested by the legislators, who are in the best position to know what they need to discharge their functions in our system of government. Even in the context of contractor and grantee lobbying, section b(1) has been designed to avoid such interference with formal congressional hearing and normal informational interchange processes.

E. Evidence of Confusion Regarding Current Lobbying Restrictions

Several commenters argued that too few instances of the use of Federal funds for lobbying activities had been cited to justify the revision. However, as noted in the November proposal, the number of adjudicated violations was limited by enforcement difficulties, not necessarily an absence of abuses. Before the revision, it has been very difficult for auditors to obtain evidence of outright violations or fraud that could be prosecuted, or of mistakes in application, so they could be corrected. Such items were typically carried on the books as part of an organization's indirect costs, and not broken out by category.

While various statutes mandate that taxpayer funds not be used for lobbying on legislation and electioneering, and while there is clear policy consensus that no Federal funds should be spent for these purposes, the Inspectors General have reported that effective auditing of the use of Federal funds for lobbying is not possible under the existing Circular. For example, Charles Dempsey, HUD's Inspector General and Chairman of the Prevention Committee of the President's Council on Integrity and Efficiency, has stated that:

> We do not believe that effective auditing of the use of Federal funds for lobbying purposes is possible under the current OMB Circular A-122. Moreover, we do not believe that, given the current Circular, it is possible to know or otherwise assess the extent to which Federal funds are used for lobbying purposes.

However, even with the current auditing difficulties, a number of instances have been uncovered in which there is, at a minimum, confusion on the part of agencies and grantees as to allowable and unallowable costs in the area of lobbying. Examples include:

- A Department of Education grantee under the Women's Educational Equity Act Program recently conducted a two-day conference in Washington, D.C. According to the conference program, one afternoon was largely devoted to a discussion of "political action and participation." The other afternoon was devoted in its entirety to "a visit to Capitol Hill and meeting with legislators." The program itself noted that the conference had been funded by the Department of Education.
- A September 1982 GAO study of grantees under Title X of the Public Health Service Act audited representative grantees, and found that some incurred "expenses that, in our opinion, raised questions as to adherence with Federal lobbying restrictions." GAO/HRD-82-108.
- GAO found that a mass transportation grantee prepared and distributed a newsletter, a portion of which urged its readers to write to the Congress to support continued funding of a "People Mover Project." *The agency was deemed responsible* for not informing its grantees that expenditures of grant funds for this purpose were not permissible. (B-202 975, November 3, 1981.)

As noted, the GAO in September 1982, recommended a cost circular revision on lobbying. And, as further noted, the current revison has been prepared in active consultation with the GAO, which supports it. The revision will now make it possible for the Federal government to better ensure that appropriated monies reach their proper objective, while limiting the amount of documentation auditors may demand from nonprofit entities in auditing and negotiating situations. Similarly, for the first time, organizations will have clarified responsibilities and incentives for proper documentation, which will benefit both the private sector and the government.

F. The Proposed Revision Was Not Sufficiently Restrictive

Many commenters argued that the proposed revision was not sufficiently restrictive to curb abuses in this area. For example, the American Legislative Exchange Council, the largest individual membership organization of state legislators, argued that the revised proposal would not achieve the necessary fundamental reforms. "There is a tremendous concern across the country that some groups are using Federal dollars to advance their own narrow political interests before Congress and State legislatures . . . we believe these regulations should be stronger in requiring a strict accounting of Federal grant money."

Similarly, Taxpayers for Less Government recommended broadening the definition of unallowable lobbying to include the lobbying of several types of government entities not covered under the November proposal, such as school boards and independent regulatory commissions. It also recommended that all forms of legislation be explicitly covered, including bills, appropriations, declarations, ratifications and calls for conventions. It also contended that, "[c]ourt cases on any of these areas should also be prohibited with the use of tax funds; if a group has a legal dispute, the taxpayer should not have to underwrite the extensive litigation process."

The Stockholder Sovereignty Society advocated several changes to tighten the revision: (1) Assess double or treble damages against violators; (2) debar violators from participating for five years in the particular program from which funds were diverted for lobbying or related activities; and (3) debar any parent, subsidiary, or other controlled organization of violators.

Many other commenters opposed the omission of local level lobbying from the revision, contending that there is no rational basis for funding one level of lobbying (local) when another (Federal) is made unallowable. Many also argued that the revised Circular should reflect the principle of "preemption." For example, the United States Business and Industrial Council stated "[n]onprofit organizations should be required to choose between political activism and Federal subsidies. Preemption would allow nonprofits to lobby, but only on condition that they disavow Federal funds." Such an approach would be far more restrictive than OMB's January 1983 proposal.

Braddock Publications argued that, with adoption of the allocation method,

the 25% recordkeeping rule created an unfortunate loophole. "A '10% rule' would be more reasonable and would still address the concerns of those groups which lobby very little."

OMB has carefully considered but not accepted these suggestions. In OMB's judgment, the November 1983 revision, as modified in this final publication, constitutes a major, workable management initiative which represents the best achievable compromise among the interested parties, while fully protecting their interests. OMB also considered and rejected more extensive "sunshine" provisions which would have called for full disclosure by recipient organizations of detailed information concerning their personnel, public policy positions, affiliations of officers and directors, publications, and other such information. OMB believes such reporting requirements would exceed those necessary to achieve the purpose of this revision to ensure that Federally appropriated funds are not used for lobbying activities by grantees and contractors.

VII. Analysis of Comments and Resulting Changes to Proposal

The revision creates a new paragraph in Attachment B to Circular A-122, to be called "B21 Lobbying." Paragraph B21 consists of three subparagraphs, which in turn contain a total of thirteen sections.

A. Unallowable Lobbying—Subparagraph a

Enforcement of the current restrictions on tax-funded lobbying has been hampered by the lack of a clear definition of what activities are unallowable. In constructing the definitions and standards in this revision, OMB has drawn where appropriate upon experience with the Internal Revenue Code, statutory provisions, Defense, GSA, and NASA procurement regulations, and similar authorities. Great care has been taken to avoid prohibiting reimbursement for activities that are legitimately necessary to fulfill the purposes of a grant or contract.

Subparagraph a defines five categories of lobbying activities that are unallowable for reimbursement. It should be read in conjunction with subparagraph b, which establishes exceptions to these provisions.

B. Electioneering—Sections a (1) and a(2).

Section a(1) makes unallowable certain electioneering activities at the Federal, state, or local levels. It applies both to referenda, initiatives and similar campaigns, as well as to elections of candidates to office. The restrictions should be familiar to nonprofit organizations, since they are prohibited by 26 U.S.C 501(c)(3). This section is narrower than the Code in one respect, however, because it is confined to "contributions, endorsements, publicity, or similar activity," while the Code broadly prohibits "participat[ing] or interven[ing], directly or indirectly * * *."

Section a(2) makes unallowable the financial or administrative support of political entities—including political parties, campaigns, political action committees, or other organizations—for the purpose of influencing elections. Thus, it bars indirect support of electioneering activities through intermediaries. This section also follows the definition of disqualifying activities under the Internal Revenue Code.

Very few commenters disagreed with the principle that use of Federal funds for electioneering and political activities should be disallowed. Some, however, argued against the "disallowance of costs associated with participation in referenda, initiatives, and similar procedures." For instance, the Catholic Social Service of Santa Clara asserted that lobbying expenditures should be allowable if incurred for an educational purpose. OMB agrees that the cost of educational activities should be allowable if they are educational and nothing more. But if the activities go further than helping persons accumulate data or comprehend its meaning, and involve partisan political activity or steps designed to influence the outcome of an election, they constitute activity that should not receive Federal funding.

The American Jewish Congress also argued that section a(1) would severely restrict political campaign involvement by organizations classified under the Internal Revenue Code as 501(c)(4) groups, which face minimal restrictions as to their political involvement. As noted above, the Code's restrictions serve merely to classify organizations for purposes of taxability. By contrast, the cost principles established through Circular A-122—including this revision—define permissable uses of Federal grant or contract money, without regard to the organization's tax status. The revision does not in any respect limit an organization's right to engage in campaign activities with its own funds.

C. Attempts To Influence Legislation—Sections a(3) and a(4)

Section a(3) makes unallowable the costs of attempts to influence Federal or state legislation through contacts with government officials. This section confines the reach of unallowable lobbying to legislative decisionmaking, and does not apply to Executive Branch lobbying, with the exception of attempts to influence a decision to sign or veto legislation, and attempts to use state and local officials as conduits for grantee and contractor lobbying of Congress or state legislatures. The coverage of section a(3) is more limited than the current prohibitions in the Internal Revenue Code, and the FAR, in that it does not apply to legislative lobbying at the local level (*e.g.*, matters such as obtaining zoning changes, police protection, or permits). Since there is no rigorous separation between legislative and executive authority at the local level, it would be difficult to construct or enforce a rule regarding legislative lobbying at that level.

Efforts to influence state and local officials to accomplish the lobbying activities defined in section a(3) are likewise unallowable. Thus, the Federal government will not reimburse an organization for the cost of meeting with mayors or city council representatives if the purpose is to convince them to lobby the Congress for legislation that the grantee or contractor favors.

The comments raised few objections to the basic soundness of the proscriptions in section a(3), although some argued that the broad coverage of the January 1983 proposal was more appropriate than the more-limited scope of the November proposal. The Conservative Caucus suggested that the costs of attempts to influence rulemakings (as well as legislation) and of local level lobbying should be added to the list of unallowable activities. Similarly, the Fairness Committee argued that reimbursement should not be allowed for *any* Executive Branch lobbying, and not simply decisions to sign or veto legislation. After careful consideration, OMB has decided not to expand the scope of this section. Rulemakings frequently have direct implications for a grantee's technical performance of its award. Furthermore, recipient organizations are likely to require regular contacts with Executive officials in the ordinary course of managing and performing the terms of the grant or contract. As stated above, this is even more certain to be the case at the local level. The granting or withholding of Executive consent to a bill is an integral part of the legislative process, however, so that this limitation on Executive lobbying is appropriate.

One commenter, the Concho Valley Center for Human Development, objected that "prohibiting lobbying at

the state level would interfere with business that is more appropriately the purview of the state legislature." Ample allowance is made in section b(2) of this revision for activities at the state level affecting the authority of an entity or the costs of performing Federal grants or contracts. Likewise, as recognized in section b(3), specific grant or contract provisions may, pursuant to Federal statutory law, make allowable certain lobbying with grant or contract funds. Apart from these exceptions, it is not the business of the Federal Government to subsidize lobbying of state legislatures.

Section a(4) deals with grass roots lobbying, and is applicable only to grass roots campaigns concerning legislation. Similar provisions are found in many appropriations riders and have been interpreted and applied by GAO on many occasions. The definition of grass roots lobbying in section a(4), however, is less inclusive than that of the Internal Revenue Code. It is limited to efforts to obtain concerted actions on the part of the public and, unlike the Code, it does ot include attempts "to affect the *opinions* of the general public," if such attempts are not intended or designed in such fashion as to have the reasonably foreseeable consequence of leading to concerted action. 26 U.S.C. 4911(d)(1)(A). The narrower reach of this section is consistent with GAO's interpretation of the prohibitions in appropriations riders on the use of funds for "publicity or propaganda." *See, e.g.*, Comp. Gen. Op. B-202975 (Nov. 3, 1981).

It was suggested that use of the term "*legislation pending*," in sections a(3) and a(4) of the proposal, was ambiguous and questioned whether that phrase applied only to bills formally introduced before a deliberative assembly, or included legislation in the process of development. In response to that concern, these sections have been amended to specify that they apply when the activity in question constitutes an attempt to influence either "the introduction of Federal or state legislation" or "the enactment or modification of any pending Federal or state legislation." This language, especially when considered in conjunction with the phrase "costs associated with" which commences subparagraph a, should clarify that the costs of preparing, instigating or urging legislation not yet formally introduced are just as unallowable as lobbying with regard to bills that have already been introduced.

Several commenters, including CARE and the National Association of Manufacturers, expressed concern that costs of an activity not originally intended to promote legislative advocacy might be disallowed, after the fact, if it were later discovered that the activity or its proximate effects did in fact lead to the development and promulgation of legislation. The revision addresses this problem. The limitation on "costs associated with * * * any attempt to influence * * * legislation," as used in sections a(3) and a(4), includes costs which support or facilitate pursuing or developing legislation before its formal introduction. However, the key phrase in the final version of sections a(3) and a(4) is "attempt to." This phrase requires intent or conduct with the reasonably foreseeable consequence of initiating *legislative action, or to support or* facilitate such ongoing action, in order for its actions to be categorized as "*unallowable*."

The language of sections a(3) and a(4) has been amended in minor respects so that it tracks more closely those provisions of the Internal Revenue Code which establish the activities that constitute "influencing legislation." Section a(3) tracks 26 U.S.C. 4911(d)(1)(B), which prohibits "an attempt to influence any [Federal, state or local] legislation through communication with any member or employee of a legislative body, or with any government official or employee who may participate in the formulation of the legislation." Similarly, section a(4) follows 26 U.S.C 4911(d)(1)(A), which defines "influencing legislation" to include "any attempt to influence any [Federal, state, or local] legislation through any attempt to affect the opinions of the general public or any segment thereof." As previously noted, sections a(3) and a(4) are narrower than the comparable Code provisions in several respects.

D. Legislative Liaison—section a(5)

Section a(5) *makes unallowable the* cost of legislative liaison activities when they are in furtherance of unallowable activities as defined in sections a(1)–(4). While a key purpose of an organization's "legislative liaison" activity may be to direct and prepare for what has been defined in this revision as unallowable lobbying, it may also serve other functions that this revision does not make unallowable. By contrast, under the current Defense Department Supplement to the FAR, *all* legislative liaison activities are deemed unallowable.

OMB received more technical comments on this section than any other part of the proposal. Some commenters argued that, since the Internal Revenue Code does not disallow "legislative liaison" for purposes of determining organizations' tax-exempt status, neither should Circular A-122. However, the IRS does not exempt legislative liaison activities from treatment as lobbying—it merely does not recognize legislative liaison as a separate category of lobbying. Legislative liaison activities which, in the language of section a(5), were "in support of or in knowing preparation for an effort to engage in unallowable lobbying" would be covered by the IRS bar. In any event, however, and as discussed above, the revision is concerned not with *determining* the tax status of entities, but with the proper use of Federal funds by recipient organizations. Use of the term "legislative liaison" in section a(5)—in its present, narrow sense—can now not excuse or mask lobbying activities by grantees or contractors.

Many other commenters argued that the proposed section a(5) was ambiguous. In particular, they objected that the compound effect of prohibiting "legislative liaison" contributing to support "lobbying and related activity" was vague, and that the proposal was *difficult to construe because it employed* a double negative—that is, all "legislative liaison" costs were unallowable unless the activity was unrelated to lobbying. The final version of section a(5) has been revised to accommodate these concerns. The new language provides that "legislative liaison" is unallowable only "when such activities are carried on in support of or in knowing preparation for an effort to *engage in unallowable lobbying*."

The "knowing preparation" requirement in the final revison should avoid unintended retroactivity problems by not permitting auditors to automatically disallow legislative liaison costs in every instance where they are associated with later efforts at lobbying. While responsibility for establishing the allowability of costs rests, here as in all aspects of cost *reimbursement*, with the parties seeking it, the "knowing preparation" standard of section a(5) is a particularly favorable one for grantees and contractors. Thus, only those legislative liaison activities which, from their timing and subject matter, can reasonably be inferred to have had a clearly forseeable link with later lobbying fall within the "knowing preparation" standard of section a(5).

Finally, it should be noted in connection with section a(5) that the term "costs associated with," which commences subparagraph a, is fully applicable. *This means* that the proscription in section a(5) extends not only to costs directly attributable to

performing a "legislative liaison" activity, but also to costs that support or facilitate its performance. Likewise, the technical status of a piece of legislation (*i.e.*, whether it is formally introduced, referred or enrolled) is not dispositive of the issue whether the costs of "legislative liaison activities" are unallowable within the meaning of section a(3).

E. Exceptions to Unallowable Lobbying—Subparagraph b

Subparagraph b contains three exceptions to activities disallowed under subparagraph a. The subparagraph does not necessarily make the costs of these activities *allowable;* allowability or unallowability of such costs will be determined by the terms of the grant, contract, or other agreement involved. Circular A-122 does not authorize costs or expenditures; it merely limits the allowability of costs or expenditures.

Some commenters noted that the use of the term "not unallowable" in the introductory clause to this subparagraph in the November proposal might indicate a fine legal distinction which grassroots volunteers would be unlikely to comprehend or which would lead to needless confusion. For clarity, the introduction of subparagraph b has accordingly been modified to provide that "the following activities are excepted from the coverage of subparagraph a." For this reason, activities which are not defined as lobbying by subparagraph a, *e.g.*, informational communications by organizations with its members or the distribution by organizations of nonpartisan analyses, are not set forth as separate sections of subparagraph b. To the extent that those, or any other activities, otherwise fall within the definitional terms of any section of subparagraph a, they are deemed unallowable unless they fall within the exceptions defined by subparagraph b.

F. Legislative Requests for Technical and Factual Information—Section b(1)

Section b(1) exempts from subparagraph a technical and factual presentations to a legislative audience on a topic directly related to grant or contract performance and offered upon a documented request, even though the presentation would otherwise constitute unallowable lobbying. Since contacts with legislative sources are not made unallowable in the first place unless they are for purposes of influencing legislation, this exception is relevant only to those legislative contacts made unallowable under section a(3). The exception is meant to fulfill the specific informational needs of legislatures, and members and staffs thereof, and has been revised extensively to reflect concerns expressed in the comments and by members of the interested Congressional committees.

The term "technical advice or assistance," used in the November 1983 proposal to define the scope of the exception, has been changed to provide that costs of rendering "technical and factual presentation of information" may be excepted. The term "factual" was added after "technical" to clarify that, to be reimbursable, the services rendered in a section b(1) situation must be overridingly informational in purpose and content, and not advocatory. However, the fact that an advocatory conclusion is reached does not in itself make the presentation unallowable. As previously indicated, this exception will avoid separate accountings and disallowances for each kernel of information provided in a lobbying effort, and will restrict the exception to "presentation[s]" which are in fact and which would be clearly seen as "technical and factual" in character. This change will allow and advocatory conclusion to be communicated with no disallowance for the time and effort involved in preparing or communicating the conclusion, provided of course that it clearly and naturally flows from the technical and factual data presented, and is a distinctly minor aspect of the overall presentation. In addition, the lobbying effort excepted by section b(1) is confined to information on a topic directly related to the performance of a grant, contract or other agreement.

A requirement that the presentation of such information is to be provided through "hearing testimony, statements or letters" also has been added to the scope provision, in response to a Congressional suggestion. This change helps clarify that, with the exception of travel, meals and lodging costs in connection with a(3) lobbying, such information need not necessarily be tendered in formal testimony to fall within this exception.

Discussions with Congressional staffs revealed concerns that legislators' routine business of information gathering in connection with hearings, drafting bills and other legislative functions might be hampered if the types of requests sufficient to invoke the section b(1) exception did not include oral requests, especially by telephone. Accordingly, the condition that the request be "written" has been changed to a requirement that it be "documented." The final version of section b(1) de-emphasizes the necessity for stringent request documentation requirements. The section also now states explicitly that the technical information exception is invoked by notices in the *Congressional Record* requesting testimony or statements for the record at regularly scheduled hearings. Some persons suggested that some of the routine information-gathering functions of the legislative bodies might be disrupted if such notices and responses to them were not specifically included in section b(1). As indicated below, for its costs to be excepted, the presentation must not only be of a "technical and factual" nature, but must also be "readily obtainable and can be readily put in deliverable form."

Several commenters expressed uncertainty about the requirement that, to fall within the exception, technical advice or assistance to legislative bodies must be "in response to a *specific* * * * request." The term "specific" has therefore been deleted from this final version of section b(1). This change does not affect the underlying intent that requests sufficient to invoke this exception must be *bona fide*, may not be open-ended or indeterminate, and must not be made for the purpose of circumventing the subparagraph a restrictions.

Section b(1) now requires that the request for information be "made by the *recipient* member, legislative body or subdivision, or a cognizant staff member thereof." This language, articulating a condition implicit in the November 1983 version, makes explicit that the person or committee requesting the information should be the recipient, so that, for example, a request by one employee of the legislative branch could not be advanced as justification for allowing the costs of a lobbying mailing to each Member of Congress.

The term "cognizant staff member" has been inserted in response to Congressional comments that the November 1983 language might require personal attention by legislators to each request for factual or technical information. Linking the request from a staff member to that person's "cognizance" of the matters for which the information is sought is intended to ensure that the request is a *bona fide* request for information of a truly factual and technical nature, not otherwise readily available to the legislators.

When the above changes were made to greatly ease the implementation of the exception, it became necessary to put some limit on the costs that grantees and contractors could charge the Federal government when undertaking

such lobbying. With the elimination of the requirement for a written request, and the addition of the provision allowing *Congressional Record* notices to suffice for providing such information at government expense, a corresponding potential was created for unduly substantial Federal financing of lobbying.

In order to ensure that the information and its preparation are the true bases of the cost, section b(1) has been revised to require that the response must be information that "is readily obtainable and can be put in readily deliverable form." (This provision is intended to restrict and relate to the costs of acquisition and delivery of information, not the time involved in responding to requests.) Provision of such assistance justifies invoking the exception only when the information is known or obtainable—and in such form—as to be readily produced and delivered. The section b(1) exception was included in order that legislators could draw on the expertise and data possessed by nonprofit organizations—even while offered as part of a lobbying effort. This section, however, does *not* justify paying for research projects or otherwise incurring significant charges to grants or contracts to develop information not readily at hand.

Likewise, in order to limit Federal payment for lobbying to technical and factual presentations most likely to produce expert information not readily obtainable elsewhere, the further requirement has been added that the presentation be linked to information "derived from the performance of a grant, contract or other agreement." This provision permits the exception to be invoked for information not only derived from grants or contracts presently in effect but also information on topics directly related to grant or contract performance. Nonetheless, a direct nexus between the topic of a grant, contract or other agreement and the technical and factual presentation will be required to be shown.

While the revision seeks to maximize the free flow of information from Federal fund recipients to Congress, this does not mean to allow grant funds to pay for lobbying trips to Washington simply because part of that trip was devoted to delivering information to a staff member, or delivering essentially unsolicited statements or testimony to a Committee hearing.

To deal with this problem, the revision provides that Federally-reimbursable costs under this exception could not include travel, lodging or meal costs, except when incurred for the purpose of providing Committee hearing testimony upon written request for a technical and factual presentation. To help ensure that the Federal financing of lobbying trips to Washington is limited to those which Congress deems necessary to its decision-making, the revision provides that these otherwise restricted costs (travel, lodging and meals) can only be "incurred to offer testimony at a regularly scheduled Congressional hearing pursuant to a written request for such presentation made by the Chairman or Ranking Minority Member of the Committee or Subcommittee conducting such hearing." To the degree possible, the cost of providing information requested by legislators should be paid for out of the legislative budget. Both houses of the Congress have rules providing for payment of expenses relating to Congressional testimony. (*See*, Senate Resolution 338, 96–2; House Rule 35.)

The American Civil Liberties Union challenged the entire section b(1) exception on the grounds that linking the exception to a special legislative invitation constitutes an impermissible regulation of free speech on the basis of content. The reimbursement provisions set forth in section b(1) do not discriminate against any person's speech but turn instead on the type of assistance rendered. Under *Regan*, the Supreme Court has ruled that no entity has a right to have its speech subsidized with Federal funds. Thus, it is constitutional to establish general cost guidelines to clarify the types of lobbying for which the government will provide reimbursement. Indeed, this section is based upon a similar provision in the Internal Revenue Code. It bears repeating that nothing in this revision prohibits grantees or contractors from conducting any form of lobbying or making any kind of communication to Congress they wish, as long as they do so with their own funds.

G. State Level Lobbying Related to Performance of Grant or Contract—Section b(2)

Section b(2) exempts lobbying otherwise unallowable under section a(3) to influence state legislation in order to directly reduce the cost or to avoid impairment of the organization's authority to perform a grant, contract, or other agreement. Such lobbying is permitted because it can directly benefit the Federal government by helping minimize the costs of award performance. The exception does *not*, however, permit the use of Federal funds to lobby state legislatures to promote an organization's ideological objectives merely because those objectives are consonant with the purposes of the grant or contract.

A primary concern for several national organizations that commented on this proposal was the problem of determining how closely legislation must directly affect the performance of a grant or contract in order to fall within the proposed exception. A related concern was the possibility that an activity could serve multiple purposes, some of which would and some of which would not "directly relate" to the organization's grant mission.

In the final version, the term "directly affecting" has been deleted, and other changes made to the language to clarify the precise scope of the exception. Thus, the lobbying affected by the exception is specified to be only that made unallowable by section a(3). Additionally, the phrase "at the state level" was deleted in favor of the greater clarity provided by the phrase "to influence state legislation." Finally, the phrase "or related activity" after "lobbying" has been dropped, consistent with changes throughout the revision.

The most significant substantive change made to this section was deletion of the phrase "ability of the organization," which several commenters argued was far too broad. For example, the "ability of the organization" to perform a grant, contract, or other agreement could be construed to include those secondary, tangential, or speculative aspects of the activity that the November 1983 preamble indicated did not fit properly within the exception. 48 FR at 50885. OMB has deleted this language and replaced it with a reference to an organization's basic "authority" to perform the activity, thus eliminating the potentially overbroad applications that could be associated with the term "ability." The potential for such abuse is made evident by the incident described below:

> ANNAPOLIS, March 7—Administrators of two community-based programs for the mentally retarded led several hundred clients in a demonstration here today in support of bills that would raise employes' salaries and exempt their organizations from state procurement laws * * *
>
> [The demonstration organizer] said that all participants in today's demonstration had been "educated intensively" about the reason for the demonstration and had elected to come, although some might have forgotten by the time they arrived, he said * * *
>
> Demonstration organizers defended the tactic saying the bills, if approved, will directly affect the clients by improving the quality of care they receive * * * [*See*, *Washington Post*, March 8, 1984, pp. C1, C5.]

Under the November 1983 proposal, a strained argument could be made under the concept of "ability to perform" that the lobbying on the bills described above should fit within the exemption—a wholly unintended and inappropriate result. By focusing on an organization's "authority" instead of its "ability" to perform, the revised language should eliminate any confusion as to what was intended by the exception. Moreover, by modifying the reference to "cost" to include only cost reductions, the revised language precludes lobbying for higher salaries and reflects the point made in the November 1983 preamble, that the exception is intended to allow lobbying for lower costs or better performance of grants or contracts. These changes guarantee that the only lobbying costs reimbursable under the exception will be those that relate to the organization's direct performance of the grant or contract in the most cost-efficient manner possible, or its very authority to perform the grant or contract.

A state waiver clause was added to the November 1983 notice in response to concerns raised by some nonprofit organizations. That clause would have permitted states to make Federally reimbursable the costs of all state lobbying by their Federally-funded subgrantees. Upon further review, however, the clause was determined to be superfluous, and potentially troublesome for several reasons. Some nonprofit commenters found the exception confusing; subject to partisan political pressures, and a needless cause of complexity for grant rules. Under none of Circular A-122's other 50 cost categories do states have the right to determine which costs will be eligible for Federal reimbursement. Furthermore, any lobbying "to influence State legislation in order to directly reduce the cost, or to avoid material impairment of the organization's authority to perform the grant, contract or other agreement," is already excepted by the remainder of section b(2).

H. Lobbying Authorized by Statute—Section b(3)

Section b(3) exempts any activity specifically authorized by statute to be undertaken with funds from Federal grants, contracts, or other agreements. This technical section reflects that the provisions of this Circular do not override statutory law. Only minor wording changes—with no change of substance—were made from the wording of this provision in the November proposal.

I. Exceptions Deleted from November Proposal

Section c(2) in the November 1983 proposal specified that communications with Executive Branch officials would not be unallowable, with two exceptions now set out in section a(3): (1) To influence a decision to sign or veto legislation, or (2) to influence state or local officials to serve as conduits for unallowable lobbying activities. This section had been inserted solely for the purpose of clarifying that the only Executive Branch communications regulated by the revision are those relating to signing or vetoing legislation, or serving as a lobbying conduit.

On the other hand, it is not intended that proscriptions should be created by implication from the fact that a type of activity is not specifically excepted in subparagraph b. Hence, section c(2) has been omitted entirely, since the only Executive Branch contacts unallowable in the first place are those dealing with a decision to sign or veto enrolled bills, as specified in section a(3). As indicated by the new language introducing subparagraph b, the final version of the subparagraph contains only exceptions to activities which are otherwise unallowable.

Section c(3) of the November proposal also has been deleted, since other provisions of the revision make it superfluous. This section concerned the application of the "tainting" principle of the January proposal which was eliminated in the November proposal and replaced by the current proportional "allocation" principle. The inclusion of section c(3) in the November revision was inadvertent and has been corrected.

J. Accounting Treatment of Unallowable Costs—Subparagraph c.

As with the Federal Acquisition Regulation and as is already the case under Circular A-122's general rules for unallowable costs, the costs identified as unallowable by this revision include not only costs of the direct activity itself but also the costs of other activities supporting that activity. For example, if a lobbyist spends four hours lobbying the Congress and an additional eight hours in study, consultation, and preparation for the lobying, the full twelve hours, with the cost of any support services and any other costs attributable to the lobbying activity, are disallowed.

As emphasized in the comment published with the text of the November proposal, only the portion of those cost items allocable to the lobbying activity is unallowable. Thus, if an employee spends 60% of his time on lobbying activities and 40% on Federal grant activities, 40% of the salary may be allocated to the grant. This approach is consistent with the FAR lobbying cost treatment provision, as well as with the traditional accounting method of prorating costs between allowable and unallowable activities.

OMB considered and rejected an alternative method of allocating costs of items used for both lobbying activities and grant or contract purposes, namely, the concept that no Federal money can be used to pay for any portion of a cost item used for lobbying activities: (1) In any way, or (2) over 5% of the time. The OMB proposal published in January 1983 followed this stricter approach. Commenters argued that it would increase the cost of performing Federal grants and contracts by effectively requiring them to separate their lobbying activities from their grant or contract activities and could also lead to inefficient duplication of equipment and facilities. They also argued that it would burden the First Amendment rights of contractors and grantees because engaging in lobbying activities could result in otherwise legitimate costs being disallowed. As set forth in the November notice, OMB has adopted a different approach which alleviates these concerns and serves the goal of assuring government neutrality by disallowing reimbursement of Federally appropriated funds used for certain types of lobbying.

K. Indirect Cost Rate Proposal—section c(1)

Subparagraph c establishes an administrative framework for the overall revision. Section c(1) follows current cost allocation principles familiar to grantees and contractors and establishes a general format similar to that now applicable to comparable unallowable activities.

Indirect cost rate negotiations are conducted between an organization and a single cognizant agency on an organization-by-organization, rather than on a grant-by-grant basis. This approach saves agencies and recipient organizations considerable time and effort in cases where the organization receives more than one grant or contract. The revision has been modified to reflect this approach. Further, section c(1) follows existing accounting practice and emphasizes that lobbying costs must be identified and dealt with appropriately, in accordance with the Circular's indirect cost rate provisions.

Although very few commenters criticized section c(1), some—including Congressional sources—expressed concern that the November proposal's

language could be broadly interpreted by agency auditors. Further, they suggested that lobbying costs, because of their political nature, should be subject to only very limited, if any, disclosure.

The purpose of section c(1) was simply to require accounting information necessary for the government to calculate the reimbursement of indirect (overhead) costs. Such information is already made available to auditors through existing recordkeeping requirements in Circulars A-122 and A-110.

However, to clarify OMB's intent to request only the minimum amount of accounting data to comply with existing accounting guidelines, OMB has rewritten section c(1) following consultation with GAO and Congressional staffs. In essence, only the minimal information that is needed for the calculation of Federally-reimbursed overhead costs is now required, and organizations are completely exempt from this section if they do not seek such Federal reimbursement.

The new section c(1) says that only the *total* lobbying costs must be identified in the indirect cost rate proposal. This will allay concerns of nonprofit groups that separate accountings and disclosures were mandated for each of the five component definitions of lobbying set forth in sections a(1)–a(5). Moreover, since this information is made necessary only for indirect cost calculations in order to avoid Federal subsidization of the lobbying process, this sentence also explicitly makes clear that no such disclosure is required by the revision unless the grantee seeks reimbursement for indirect costs. (See also, Internal Revenue Service Form 990, requiring lobbying cost disclosure, which many nonprofit organizations now submit.)

In comparison with the November proposal, the new section c(1) sharply reduces the accounting data requested, eliminates language that some thought gave agencies too much discretion in requesting information, and explicitly ties the treatment of lobbying costs to existing Circular A-122 requirements. The November proposal's requirement of "a statement, identifying by category, costs attributable in whole or in part" to lobbying, as well as the requirement of a statement of "how (lobbying costs) are accounted for," have been deleted.

When the existing Circular A-122 accounting requirements are reviewed in conjunction with the uniquely lenient recordkeeping treatment provided for lobbying in section c(4) of the revision, it becomes clear that such information is the minimum necessary to achieve an acceptable level of accounting integrity, and that the overall recordkeeping required for lobbying costs is much less than that required for any other type of allowable or unallowable cost.

It should of course be noted that the stated requirement that organizations must "separately identify" their total lobbying costs cannot be construed to limit auditors or indirect cost analysts from requiring more detailed breakdowns when such information would normally be required under existing indirect cost rate proposal guidelines. *See, e.g.*, the Department of Health and Human Services' "Guide for Nonprofit Organizations" (May 1983) at 73 (Sample Indirect Cost Proposal Format—Direct Allocation Method). Additionally, if auditors suspect that an organization may have misstated its unallowable lobbying costs, they are not constrained from requesting any data normally accessible under Circulars A-122 and A-110, as long as such data does not fall under the recordkeeping exemption provided in section c(4).

Section c(1) follows existing Circular A-122 requirements that provide for the general disclosure of the costs spent on unallowable activities. This requirement is necessary so that when the government calculates the amount of an organization's indirect costs (*i.e.*, overhead) that it will pay, it does not include the costs of unallowable activities that the organization happens to account for as indirect costs. Paragraph B.3 of the existing Attachment A to Circular A-122 now requires this:

> The costs of certain activities are not allowable as charges to Federal awards (see, for example, fund raising costs in paragraph 19 of Attachment B). However, even though these costs are unallowable for purposes of computing charges to Federal awards, they nonetheless must be treated as direct costs for purposes of determining indirect cost rates and be allocated their share of the organization's indirect costs if they represent activities which: (1) Include the salaries of personnel, (2) occupy space, and (3) benefit from the organization's indirect costs.

Some persons argued that unallowable costs need not be reported, since they are not Federally reimbursed. However, it is impossible for the government to properly determine the extent to which it should pay for an organization's indirect costs unless it can determine what portion of the organization's total indirect costs are from allowable activities, and what portion are unallowable. Such treatment is currently required under Circular A-122's Attachment A, Section D: "Allocation of Indirect Costs and Determination of Indirect Cost Rates."

Further, some persons argued that the disclosure requirement should expressly authorize that initial submissions in indirect cost rate proposals set forth an aggregated figure representing both lobbying and other unallowable costs. Such an approach would codify the current practices of most (but, it should be pointed out, not all) grantees, a not unsurprising fact in light of the vagueness of the current standard and the relative lack of audit resources applied to determining whether lobbying activities are supported by Federal grants and contracts. There is agreement that auditors would be able to obtain and would indeed require disaggregated information on lobbying costs if they engage in specific auditing of lobbying disallowances.

In weighing this proposal against agency auditors' concerns that detailed breakdowns of lobbying costs are critical to proper cost analyses, OMB has resolved to require that only the total amount of lobbying costs be initially disclosed in the indirect cost rate proposal. OMB has determined that it would make no sense to rely on varying and what would almost certainly be inconsistent initiatives of individual auditors, regional offices and agencies to inquire, as a matter of standard practice, into whether lobbying activities are being improperly subsidized through indirect cost allocations—or to rely on random audits to accomplish this purpose. Thus, the final revision requires, consistent with paragraph B.3 of Attachment A and at a level of specificity less than that generally provided for fundraising activities, *i.e.*, disclosure only of a total, lump sum lobbying cost figure. Disclosure of such a figure will give auditors a basis for further inquiry into lobbying cost estimates set forth in particular indirect cost rate proposals, and will provide a level of detail that actually would be minimally required in every instance in which an auditor seeks to determine whether Federal subsidization of lobbying is taking place through the overhead mechanism. Given the 25% rule which makes more difficult auditor disallowances of lobbying estimates, this balanced compromise—and reduction in the level of detail called for in the November 1983 proposal—is in OMB's judgment a minimal requirement consistent with the Circular's accounting guidelines.

L. Certification Requirement—Section c(2)

The requirement in section a(2) of the November 1983 proposal, that certification accompany the Financial Status Report, has been changed in the final version to a requirement that certification accompany an organization's annual indirect cost rate proposal. Since a Financial Status Report is required for each grant that an organization has, while an organization must file only one indirect cost rate proposal per year to cover all of its grants, this change reduces paperwork and administrative effort.

Further, lobbying expenses are usually included in indirect costs, which are calculated on an organization-wide basis. Consequently, the appropriate place to certify such costs is in the annual indirect cost rate proposal, as required under the Defense and GSA proposed revisions. In addition, most future audits will be "single audits" of all Federal funds received by the grantee, so there will be less emphasis on the Financial Status Report and more on the indirect cost rate proposal.

M. Recordkeeping—Sections c(3) and c(4)

Documentation of the amounts of allowable and unallowable costs became a necessity when the method of cost treatment was changed from total disallowance of cost items partially involved in lobbying (the January 1983 proposal) to the typical "allocation" cost treatment. The principal alternative considered by OMB was to adopt the documentation philosophy of the restrictions on lobbying in the prior Defense, GSA, and NASA procurement regulations, *i.e.*, to place the burden on the grantee or the contractor to prove in all instances the appropriateness of a cost. This approach, while consistent with the cost principles in general, would entail an implied burden on some indirect cost employees to maintain records (time logs, calendars, or the like) to establish the proportion of their time spent on lobbying. This would be of particular concern for high level officials of grantees and contractors who, in the ordinary course of business, may engage in only a small amount of lobbying. OMB (along with Defense, GSA, and NASA) will therefore allow grantees and contractors to certify in good faith the amount of their employee's time attributable to lobbying activities.

No detailed recordkeeping requirements have been included in this revision, as these requirements are generally set forth for all nonprofit organizations in OMB Circular A-110: "Grants and Agreements with Institutions of Higher Education, Hospitals, and Other Nonprofit Organizations: Uniform Administrative Requirements" (*See, e.g.*, Circular A-110, Attachments C and F.) That Circular generally requires grantees, *inter alia*, to keep for a period of three years, "[f]inancial records, supporting documents, statistical records, and all other records pertinent to [grants]," and to access for audit purposes "pertinent books, documents, papers and records of * * * recipient organizations."

Section c(3) restates the general rule for cost documentation, but is modified by section c(4), which provides that for the purposes of complying with this revision, employees are not required to prepare or maintain time logs, calendars, or similar records to document the portion of their time treated as an indirect cost. This means that the agency and auditor must rely on the employee's good-faith estimates of time spent in lobbying, or upon other evidence not otherwise precluded. As noted earlier, the absence of time logs or comparable records for indirect cost time not kept pursuant to the discretion of the grantee or contractor will not serve as a basis for government auditors disallowing claims of allowable costs by contesting unallowable lobbying time estimates except in two distinct situations: first, where the employee spends more than 25% of his compensated hours of employment during a month lobbying; and, second, where a material misstatement of costs has been found within the preceding five years. This avoids the necessity of employees who engage in only incidental lobbying having to account for all of their time to Federal agencies. Moreover, by making each calendar month an independent, operative period under section c(4), problems of retroactivity are avoided by persons unexpectedly required to engage in intensive lobbying during the latter portions of a larger operative period such as a calendar year. Alternatively, persons engaged in intensive lobbying activities during the earlier portions of such a longer operative period will not lose the protection of section c(4) during latter months of the longer period when lobbying activities fall below the 25% trigger. However, it should be stressed that in the exemption from "records which are not kept," the primary sense of the word "kept" was "created." Thus, records that would otherwise be kept in the ordinary course of business cannot be destroyed simply to avoid audit inspection merely because they are not required under this exemption.

For two significant reasons, the last sentence of this section, as proposed in the November 1983 version, has been deleted. It stated:

> Agency guidance regarding the extent and nature of documentation required pursuant to subparagraph (c)(3) shall be reviewed under the criteria of the Paperwork Reduction Act to ensure that requirements are the least burdensome necessary to satisfy the objectives of this subparagraph.

Commenters questioned why, if such a provision was necessary in the first place, other laws, such as the Regulatory Flexibility Act, were not included. Such a reference to compliance with existing laws is not necessary, and the reference to the Paperwork Reduction Act was included to emphasize OMB's commitment that the sprit of this law be followed in the revision's implementation.

Morever, the Department of Health and Human Services noted that the sentence could have been read to give agencies the mandate to develop their own regulations. As there is no reason for agencies to deviate from or add to the Circular A-122 guidelines and as agency deviations could result in multiple rules for nonprofit entities—an outcome not intended by OMB and one which would create the potential for inconsistent enforcement and excessive paperwork—this sentence was eliminated from the final version.

N. Administrative Restrictions on Agencies—Section c(5)

Section c(5) requires agencies to establish procedures for advance resolution of definitional issues arising under this revision. This will alleviate the inevitable problems of interpretation at the margin and will avoid discouraging organizations from engaging in borderline activities merely because the application of the provisions may be uncertain.

Section c(5) is not intended to impose or authorize OMB micromanagement of agencies which award grants or contracts. Agencies typically have methods of resolving disagreements or differences with their grantees and contractors, and such methods shall be deemed adequate to meet the requirements of section c(5), unless OMB review of such procedures determines that changes are necessary to comply with the intent of this section.

O. Paragraph Renumbering Provision

Paragraph 2 renumbers paragraphs B21 through B50 of Circular A-122's Attachment B. Since the cost items covered under Attachment B are numbered in alphabetical order,

"Lobbying" is appropriately designated as paragraph B21, necessitating the renumbering of former paragraphs B21 through B50 as B22 through B51.

VIII. Paperwork Reduction Act Considerations

The November notice invited "comments about the appropriateness of collection of information requirements in this proposal" to be submitted to OMB's Office of Information and Regulatory Affairs. Forty-three such comments were received. Of these, twenty expressed general concerns similar to those of other commenters but raised no specific paperwork burden issues.

The twenty-three other commenters followed, almost verbatim, points raised by the Center for Non-Profit Corporations. These alleged that a "substantial increase" in paperwork would result from the recordkeeping mandated by Circular A-122. The commenters asserted that the additional paperwork burden would occur to: (1) Meet requirements for the annual indirect cost proposal, and (2) maintain the records required to demonstrate that costs are allowable or unallowable.

However, by establishing uniform and well-defined guidelines for lobbying costs, and by explicitly restricting the paperwork that auditors can require for documentation of such costs, this revision may significantly reduce the net paperwork burden to which grantees are now legally subject. Clearly, some grantees may avoid the existing paperwork requirements by ignoring the multiple—and often vague—sets of lobbying reimbursement restrictions that have been issued by the various agencies, and likewise ignore the existing accounting rules in Circular A-122 regarding treatment of such costs. Such non-compliance may currently exist in part because government auditors have found it difficult to efficiently enforce the myriad of vague restrictions on lobbying costs. With the clear guidelines provided by this revision, agency and audit enforcement will increase. Those grantees already in compliance with the differing sets of restrictions will enjoy a much-reduced paperwork burden; those who have previously ignored these restrictions will find that non-compliance is more likely to be questioned by government auditors.

Moreover, regardless of whether grantees currently choose to adhere to existing rules on lobbying, most routinely maintain detailed books regarding their expenditures. Annual financial planning by the nonprofit itself and filing requirements of the Internal Revenue Service already require maintenance of detailed records.

In general, Circular A-122 will not require employees to keep a second set of books, *e.g.*, time logs, to record lobbying. In fact, most employees who engage in lobbying are explicitly exempted from any requirements to keep time logs or other similar documents. This is because most lobbying is done by indirect cost (*e.g.*, headquarters staff) employees, and section c(4) states that employees who certify that they spend less than 25% of their compensated time lobbying do not have to keep such records documenting that portion of their time that is treated as an indirect cost. Since employees whose time is charged directly to contracts already must keep such records, no special rule for direct cost time is necessary.

The 23 critics of the revision also submitted identical comments to the effect that "[t]ax dollars will be diverted to unnecessary paperwork and needlessly drawn away from the purpose of the organizations by these requirements." As discussed above, the fact that the revision decreases, in general, existing paperwork requirements will reduce the current recordkeeping costs incurred to comply with existing restrictions.

Some commenters argued that differing Internal Revenue Code and Circular A-122 standards would require maintenance of two sets of financial books. No commenters were able to specify any situation in which a detailed set of expenditure records for lobbying would not provide sufficient information to serve the filing or audit requirements of the Internal Revenue Service as well as those of the various grant or contracting agencies implementing the revision.

OMB will review all agency information burden requests to implement Circular A-122 according to the standards of the Paperwork Reduction Act. None of the comments OMB received from agencies mentioned any specific concern over a possible increase in paperwork.

IX. Enforcement

Circular A-122 is a management directive to Federal agencies establishing cost principles for use in connection with grants and contracts with nonprofit organizations. It does not contain its own enforcement mechanism, though its terms are incorporated in grants and contracts through agency regulations or grant instruments. The degree and nature of enforcement of these anti-lobbying provisions will depend, therefore, on operational experience and competing demands on enforcement resources.

1. *Voluntary compliance.* The bedrock for enforcing these provisions is voluntary compliance by grantees and contractors. In the past, restrictions on the use of Federal funds for lobbying have been inadequately communicated and defined. Neither agencies nor recipient organizations devoted much attention to them. This revision is expected to improve compliance significantly by:

- Defining unallowable activities so that organizations can comply in good faith; and
- Providing occasions (indirect cost rate negotiations) in which responsible officials of the grantee or contractor will focus specifically on the issue of the organization's compliance.

To assist organizations in complying, agencies are to be prepared to resolve definitional questions concerning potential expenditures in advance. This procedure should reduce the inevitable difficulty of interpretations at the margin.

2. *Sanctions.* OMB considered and rejected as too stringent a penalty provision which would require the return to the Federal government of all grant or contract funds received by a nonprofit organization found to be using Federal funds to engage in lobbying. Instead, penalties for violating this revision are the same as for violations of existing Circular A-122 provisions. The principal sanction in the event of minor or unintentional violations is cost recovery, *i.e.*, the Federal agency will obtain reimbursement from the contractor or grantee of misspent funds. In more serious cases, contracts and grants can be suspended or terminated, or contractors and grantees can be debarred from further awards. The availability of these sanctions for violating the anti-lobbying restrictions of appropriations legislation has been confirmed by the Office of Legal Counsel of the Department of Justice.

3. *Audits.* Contractors and grantees are currently subject to audit requirements, and to the possibility of audit by agency Inspectors General or the Comptroller General; however, only rarely have audits focused on compliance with anti-lobbying provisions due to the difficulty of determining proper adherence to a myriad of frequently vague restrictions. After uniform cost principles are promulgated, it will become possible for uniform and effective audit enforcement to take place. Stratified audits and other strategies can be used to create an

incentive for greater compliance among all grantees and contractors. Alternatively, promulgating a defined set of rules can and will serve as a protection against audit harassment, and will and should make for fairer and simpler audits for grantees and contractors. This should be of particular benefit to smaller grantees and contractors who lack the means and support staff to contend with audits under the vague, ambiguous, and diverse rules now in effect. With expanded Inspector General and agency audit staffs now in place, the protections afforded by the proposal are manifest.

X. Designation as "Non-Major" Rule

OMB Circulars are not "rules" within the meaning of the Administrative Procedures Act or Executive Order No. 12291. Instead, they are management directives by which OMB, on behalf of the President, instructs Executive Branch entities how to exercise their authority in matters subject to agency discretion. Even if the Circular were considered a "rule," however, OMB has determined that the revision to Circular A-122 would not qualify as a "major rule" under the criteria as listed in Executive Order No. 12291, which defines a "major rule" as "any regulation that is likely to result in:

(1) An annual effect on the economy of $100 million or more;

(2) A major increase in costs or prices for consumers, individual industries, Federal, state, or local government agencies, or geographic regions; or

(3) Significant adverse effects on competition, employment, investment, productivity, innovation, or on the ability of United States-based enterprises to compete with foreign-based enterprises in domestic or export markets.

The principal effect of the revision will be to ensure that Federal grant funds are used for the purposes for which they were intended, and not to facilitate lobbying activities. As noted above, current financial control procedures do not permit an accurate estimate of the amount of tax dollars now diverted to lobbying efforts by grantees and contractors. Whether large or small, correction of this problem will produce a net gain to the intended beneficiaries of Federal programs. The costs to be considered are primarily accounting and recordkeeping costs for grantees and contractors, as well as Federal agencies. These additional costs, however, are minimal in both absolute and relative terms. Indeed, in many instances, the revisions should reduce audit and compliance costs. Furthermore, much of the accounting work that the revision requires is already mandated by other sections of Circular A-122, Circular A-110, or other provisions of law.

Issued in Washington, D.C., April 25, 1984.

Candice C. Bryant,

Deputy Associate Director for Administration.

1. Insert a new paragraph in Attachment B, as follows: "B21 Lobbying"

a. Notwithstanding other provisions of this Circular, costs associated with the following activities are unallowable:

a.(1) Attempts to influence the outcomes of any Federal, State, or local election, referendum, initiative, or similar procedure, through in kind or cash contributions, endorsements, publicity, or similar activity;

a.(2) Establishing, administering, contributing to, or paying the expenses of a political party, campaign, political action committee, or other organization established for the purpose of influencing the outcomes of elections;

a.(3) Any attempt to influence: (i) The introduction of Federal or state legislation; or (ii) the enactment or modification of any pending Federal or state legislation through communication with any member or employee of the Congress or state legislature (including efforts to influence State or local officials to engage in similar lobbying activity), or with any government official or employee in connection with a decision to sign or veto enrolled legislation;

a.(4) Any attempt to influence: (i) The introduction of Federal or state legislation; or (ii) the enactment or modification of any pending Federal or state legislation by preparing, distributing or using publicity or propaganda, or by urging members of the general public or any segment thereof to contribute to or participate in any mass demonstration, march, rally, fundraising drive, lobbying campaign or letter writing or telephone campaign; or

a.(5) Legislative liaison activities, including attendance at legislative sessions or committee hearings, gathering information regarding legislation, and analyzing the effect of legislation, when such activities are carried on in support of or in knowing preparation for an effort to engage in unallowable lobbying.

b. The following activities are excepted from the coverage of subparagraph a:

b.(1) Providing a technical and factual presentation of information on a topic directly related to the performance of a grant, contract or other agreement through hearing testimony, statements or letters to the Congress or a state legislature, or subdivision, member, or cognizant staff member thereof, in response to a documented request (including a Congressional Record notice requesting testimony or statements for the record at a regularly scheduled hearing) made by the recipient member, legislative body or subdivision, or a cognizant staff member thereof; provided such information is readily obtainable and can be readily put in deliverable form; and further provided that costs under this section for travel, lodging or meals are unallowable unless incurred to offer testimony at a regularly scheduled Congressional hearing pursuant to a written request for such presentation made by the Chairman or Ranking Minority Member of the Committee or Subcommittee conducting such hearing.

b.(2) Any lobbying made unallowable by section a.(3) to influence State legislation in order to directly reduce the cost, or to avoid material impairment of the organization's authority to perform the grant, contract, or other agreement.

b.(3) Any activity specifically authorized by statute to be undertaken with funds from the grant, contract, or other agreement.

c.(1) When an organization seeks reimbursement for indirect costs, total lobbying costs shall be separately identified in the indirect cost rate proposal, and thereafter treated as other unallowable activity costs in accordance with the procedures of paragraph B3 of Attachment A.

c.(2) Organizations shall submit as part of their annual indirect cost rate proposal a certification that the requirements and standards of this paragraph have been complied with.

c.(3) Organizations shall maintain adequate records to demonstrate that the determination of costs as being allowable or unallowable pursuant to paragraph B21 complies with the requirements of this Circular.

c.(4) Time logs, calendars, or similar records documenting the portion of an employee's time that is treated as an indirect cost shall not be required for the purposes of complying with subparagraph c. and the absence of such records which are not kept pursuant to the discretion of the grantee or contractor, will not serve as a basis for disallowing claims of allowable costs by contesting estimates of unallowable lobbying time spent by employees during any calendar month unless: (i) The employee engages in lobbying, as defined in subparagraphs a and b, more than 25% of his compensated hours of

employment during that calendar month; or (ii) the organization has materially misstated allowable or unallowable costs within the preceding five year period.

c.(5) Agencies shall establish procedures for resolving in advance, in consultation with OMB, any significant questions or disagreements concerning the interpretation or application of paragraph B21. Any such advance resolution shall be binding in any subsequent settlements, audits or investigations with respect to that grant or contract for purposes of interpretation of this Circular; provided, however, that this shall not be construed to prevent a contractor or grantee from contesting the lawfulness of such a determination.

2. Renumber subsequent paragraphs of Attachment B.

[FR Doc. 84-11284 Filed 4-26-84; 8:45 am]

[NOTE: This reprint incorporates corrections that are published in the Federal Register of Tuesday, May 8, 1984.]

BILLING CODE 3110-01-M

DEPARTMENT OF DEFENSE

GENERAL SERVICES ADMINISTRATION

NATIONAL AERONAUTICS AND SPACE ADMINISTRATION

48 CFR Part 31

[Federal Acquisition Circular 84-2]

Federal Acquisition Regulation

[NOTE: This reprint incorporates corrections that are published in the Federal Register of Tuesday, May 8, 1984.]

AGENCIES: Department of Defense (DoD), General Services Administration (GSA), National Aeronautics and Space Administration (NASA).

ACTION: Final rule.

SUMMARY: This Federal Acquisition Circular (FAC) amends the Federal Acquisition Regulation (FAR) with respect to the lobbying cost principle in the FAR subpart that covers contract cost principles in contracts with commercial organizations.

EFFECTIVE DATE: July 1, 1984.

FOR FURTHER INFORMATION CONTACT: Roger M. Schwartz, Director, FAR Secretariat, Room 4041, GS Building, Washington, D.C. 20405, Telephone (202) 523-4755.

SUPPLEMENTARY INFORMATION: The Office of Management and Budget (OMB) has directed that the agencies implement the intent and substance of the OMB Circular A-122 lobbying cost principle in FAR Subpart 31.2, Contracts with Commercial Organizations. Accordingly, the lobbying cost principle in OMB Circular A-122 has been edited and conformed to FAR format. The revised cost principle in FAC 84-2 defines unallowable lobbying cost activity in a manner consistent with the OMB circular.

List of Subjects in 48 CFR Part 31

Government procurement.

Roger M. Schwartz,

Director, FAR Secretariat.

April 25, 1984.

Federal Acquisition Circular

[Number 84-2]

Unless otherwise specified, all Federal Acquisition Regulation (FAR) and other directive material contained in this Federal Acquisition Circular is effective July 1, 1984.

Patricia Q. Schoesi,

Acting Administrator of General Services.

S. J. Evans,

Assistant Administrator for Procurement.

Mary Ann Gilleece,

Deputy Under Secretary of Defense (Acquisition Management).

Federal Acquisition Circular (FAC) 84-2 amends the Federal Acquisition Regulation (FAR) as specified below. The following is a summary of the amendment:

Item I—Lobbying Costs

The Office of Management and Budget (OMB) has directed that the agencies implement the intent and substance of the OMB Circular A-122 lobbying cost principle in FAR Subpart 31.2, Contracts with Commercial Organizations. Accordingly, the lobbying cost principle in OMB Circular A-122 has been edited and conformed to FAR format. The cost principle in FAR 31.205-22 is revised to define unallowable lobbying cost activity in a manner consistent with the OMB circular.

Therefore, 48 CFR is amended as set forth below.

Authority: 40 U.S.C. 486(c); Chapter 137, 10 U.S.C.; and 42 U.S.C. 2453(c).

PART 31—CONTRACT COST PRINCIPLES AND PROCEDURES

* * * * *

1. Subsection 31.205-22 is revised to read as follows:

31.205-22 Lobbying costs.

(a) Costs associated with the following activities are unallowable:

(1) Attempts to influence the outcomes of any Federal, State, or local election, referendum, initiative, or similar procedure, through in kind or cash contributions, endorsements, publicity, or similar activities;

(2) Establishing, administering, contributing to, or paying the expenses of a political party, campaign, political action committee, or other organization established for the purpose of influencing the outcomes of elections;

(3) Any attempt to influence (i) the introduction of Federal or state legislation, or (ii) the enactment or modification of any pending Federal or state legislation through communication with any member or employee of the Congress or state legislature (including efforts to influence state or local officials to engage in similar lobbying activity), or with any government official or employee in connection with a decision to sign or veto enrolled legislation;

(4) Any attempt to influence (i) the introduction of Federal or state legislation, or (ii) the enactment or modification of any pending Federal or state legislation by preparing, distributing or using publicity or propaganda, or by urging members of the general public or any segment thereof to contribute to or participate in any mass demonstration, march, rally, fund raising drive, lobbying campaign or letter writing or telephone campaign; or

(5) Legislative liaison activities, including attendance at legislative sessions or committee hearings, gathering information regarding legislation, and analyzing the effect of legislation, when such activities are carried on in support of or in knowing preparation for an effort to engage in unallowable activities.

(b) The following activities are excepted from the coverage of (a) above:

(1) Providing a technical and factual presentation of information on a topic directly related to the performance of a contract through hearing testimony, statements or letters to the Congress or a state legislature, or subdivision, member, or cognizant staff member thereof, in response to a documented request (including a Congressional Record notice requesting testimony or statements for the record at a regularly scheduled hearing) made by the recipient member, legislative body or subdivision, or a cognizant staff member thereof; provided such information is readily obtainable and can be readily put in deliverable form; and further provided that costs under this section for transportation, lodging or meals are unallowable unless incurred for the purpose of offering testimony at a regularly scheduled Congressional hearing pursuant to a written request for such presentation made by the Chairman or Ranking Minority Member of the Committee or Subcommittee conducting such hearing.

(2) Any lobbying made unallowable by (a)(3) above to influence state legislation in order to directly reduce contract cost, or to avoid material impairment of the contractor's authority to perform the contract.

(3) Any activity specifically authorized by statute to be undertaken with funds from the contract.

(c) When a contractor seeks reimbursement for indirect costs, total lobbying costs shall be separately identified in the indirect cost rate proposal, and thereafter treated as other unallowable activity costs.

(d) Contractors shall submit as part of their annual indirect cost rate proposals a certification that the requirements and

standards of this subsection have been complied with.

(e) Contractors shall maintain adequate records to demonstrate that the certification of costs as being allowable or unallowable pursuant to this subsection complies with the requirements of this subsection.

(f) Time logs, calendars, or similar records documenting the portion of an employee's time that is treated as an indirect cost shall not be required for the purposes of complying with this subsection, and the absence of such records which are not kept pursuant to the discretion of the contractor will not serve as a basis for disallowing allowable costs by contesting estimates of unallowable lobbying time spent by employees during any calendar month unless: (1) the employee engages in lobbying, as defined in (a) and (b) above, more than 25% of the employee's compensated hours of employment during that calendar month; or (2) the organization has materially misstated allowable or unallowable costs within the preceding five year period.

(g) Existing procedures should be utilized to resolve in advance any significant questions or disagreements concerning the interpretation or application of this subsection.

[FR Doc. 84-11042 Filed 4-26-84; 10:50 am]

[NOTE: This reprint incorporates corrections that are published in the Federal Register of Tuesday, May 8, 1984.]

BILLING CODE 6820-01-M

federal register

Tuesday
July 8, 1980

Note: This reprint incorporates corrections published at 46 FR 17185, Tuesday, March 17, 1981.

Part III

Office of Management and Budget

Circular A-122, "Cost Principles for Nonprofit Organizations"

Original A-122

OFFICE OF MANAGEMENT AND BUDGET

Circular A-122, "Cost Principles for Nonprofit Organizations"

[Note: This reprint incorporates corrections published at 46 FR 17185, Tuesday, March 17, 1981.]

AGENCY: Office of Management and Budget.

ACTION: Final Policy.

SUMMARY: This notice advises of a new OMB Circular dealing with principles for determining costs of grants, contracts, and other agreements with nonprofit organizations.

The Circular is the product of an interagency review conducted over a two-year period. Its purpose is to provide a set of cost principles to replace existing principles issued by individual agencies. These have often contained varying and conflicting requirements, and created confusion among agency administrators, auditors, and nonprofit officials. The new Circular will provide a uniform approach to the problem of determining costs, and promote efficiency and better understanding between recipients and the Federal Government.

EFFECTIVE DATE: The Circular becomes effective on issuance.

FOR FURTHER INFORMATION CONTACT: Palmer A. Marcantonio, Financial Management Branch, Office of Management and Budget, Washington, D.C. 20503, (202) 395-4773.

SUPPLEMENTARY INFORMATION: Before the Circular became final there was extensive coordination with the affected nonprofit organizations, professional associations, Federal agencies and others. All interested persons were given an opportunity to comment on the proposed Circular through informal consultations and a notice in the **Federal Register**. In response to our requests for comment, we received about 100 letters from Federal agencies, nonprofit organizations, associations, and other interested members of the public. These comments were considered in the final version of the Circular. There follows a summary of the major comments and the action taken on each.

In addition to the changes described, other changes have been made to improve the clarity and readability of the Circular. To the extent possible, we have tried to make the language of this Circular consistent with that of cost principles for educational institutions (Circular A-21), and State and local governments (Circular 74-4).

Summary of Significant Changes:

Set forth are changes that have been made in the final Circular as a result of public comments. The more significant changes to the basic Circular and Attachment A include:

1. Paragraph 2. "Supersession" was added to the basic Circular to make it clear that this Circular supersedes cost principles issued by individual agencies.

2. Paragraph 4 of the basic Circular has been amended to make it clear that the absence of an advance agreement on any element of cost will not in itself affect the reasonableness of allocability of that element. Also, this paragraph was amended to make it clear that where an item of cost requiring prior approval is specified in the budget, approval of the budget constitutes approval of the cost.

3. Paragraph 5 of the basic Circular has been changed to remove any doubt as to which nonprofit organizations would not be covered by the Circular. Now, Appendix C to the Circular lists all exclusions.

4. Paragraph 8 was added to the basic Circular to permit Federal agencies to request exceptions from the requirements of the Circular.

5. Paragraph E.2. was added to Attachment A to cover the negotiation and approval of indirect cost rates, and to provide for cognizance arrangements.

The more significant changes to Attachment B to the Circular include:

1. Paragraph 6, *Compensation for Personal Services*, was modified to:

a. Permit Federal agencies to accept a substitute system for documenting personnel costs through means other than personnel activity reports.

b. Clarify provisions covering the allowability of costs for unemployment compensation or workers' compensation, and costs of insurance policies on the lives of trustees, officers, or other employees.

c. Make unallowable any increased costs of pension plans caused by delayed funding.

d. Delete a paragraph dealing with review and approval of compensation of individual employees.

2. Paragraph 7, *Contingencies*, was changed to make it clear that the term "contingency reserves" excludes self-insurance reserves or pension funds.

3. Paragraph 10 was modified to provide that the value of donated services used in the performance of a direct cost activity shall be allocated a share of indirect cost only when (a) the aggregate value of the service is material, (b) the services are supported by a significant amount of the indirect cost incurred by the organization, and (c) the direct cost activity is not pursued primarily for the benefit of the Federal Government. Provisions were also added to this paragraph for the cognizant agency and the recipient to negotiate when there is no basis for determining the fair market value of the services rendered, and to permit indirect costs allocated to donated services to be charged to an agreement or used to meet cost sharing or matching requirements.

4. Paragraph 13, *Equipment and Other Capital Expenditures*, was changed. Capital equipment is now defined as having an acquisition cost of $500 and a useful life of more than two years.

5. Paragraph 24, *Meetings, Conferences*. The prior approval requirement for charging meetings and conferences as a direct cost was deleted. A sentence was added to make it clear such costs were allowable provided they meet the criterion for the allowability of cost shown in Attachment A.

6. Paragraph 26, *Organization Costs*, was amended to provide that organization costs may be allowable when approved in writing by the awarding agency.

7. Paragraph 28, *Page Charges in Professional Journals*, was revised to provide that page charges may be allowable.

8. Paragraph 36, *Public Information Service Costs*, was modified to make public information costs allowable as direct costs with awarding agency approval.

9. Paragraph 42, *Rental Costs*, was rewritten to:

a. Make it clear that rental costs under leases which create a material equity on the leased property are allowable only up to the amount that the organization would have been allowed had it purchased the property: e.g., depreciation or use allowances, maintenance, taxes, insurance, etc.

b. Clarify the criteria for material equity leases.

10. Paragraph 50, *Travel Costs*, was amended to delete the prior approval requirement for domestic travel. In addition to the above, a number of editorial changes were made to the original document.

Suggested Changes Not Considered Necessary.

Comment. Several respondents questioned the provision that, for "less than arm's length" leases, rental costs are allowable only up to the amount that would be allowed had title to the property been vested in the grantee organization. In their opinion this rule will result in unnecessary cost to the Federal Government, since it would encourage an organization to lease space on the commercial market at a higher rate.

Response. The cost principles are designed to cover most situations; however, there are always exceptions that must be considered on a-case-by-case basis. The Circular contains a provision for Federal agencies to request exceptions.

Comment. Several respondents questioned why interest is not an allowable cost, since it is an ordinary and necessary cost of doing business.

Response. It has been a longstanding policy not to recognize interest as a cost. However, this policy has recently been revised for State and local governments in Circular 74–4, with respect to the cost of office space. The revision provides that "rental" rates for publicly owned buildings may be based on actual costs, including depreciation, interest, operation and maintenace costs, and other allowable costs. This revision was under consideration for some time. It was studied extensively by OMB, the General Accounting Office and others, and considerable analysis went into its formulation. Suggestions for extending it to nonprofit organizations would have to be examined with equal care. This has not yet been done; and we were reluctant to further delay issuance of this Circular.

Comment. Several respondents questioned why public information costs were not allowable as an indirect cost.

Response. Public information costs are often direct services to an organization's other programs. They are allowable, however, as a direct charge when they are within the scope of work of a particular agreement.

Comment. One respondent suggested that smaller grantees be excluded from complying with the Circular.

Response. Similar rules for the 50 selected items of cost would be needed regardless of the size of the grantee. To the extent possible, the Circular provides simplified methods for smaller grantees.

Comment. One respondent said the requirements of the Cost Accounting Standards Board should be applied to cover contracts with nonprofit organizations.

Response. It is unlikely that the type of grantees covered by this Circular would have contracts large enough to be covered by the CASB. In the event that they do, however, the regulations of the CASB would apply.

Comment. One respondent said the allocation of indirect cost to donated services would pose a tremendous difficulty to the organization. The organization relies on a corps of approximately 8,000 committee members to carry out obligations in response to Government requests. There is no employer relationship in the arrangements for this assistance, nor are there committee members normally reimbursed for such services. Further, it was pointed out the committee members spend many thousands of hours outside the organization's premises conducting research.

Response. It would appear that this type of committee arrangement would not be considered in the determination of the organization's indirect cost rate provided that Federal agreements do not bear an unreasonable share of indirect cost. However, the cognizant agency will be responsible for evaluating the allocation of indirect cost where there are committee-type arrangements on a case-by-case basis.

Comment. One respondent suggested that wherever possible the language in the *Federal Procurement Regulations* be used for nonprofit organizations.

Response. The language in the *Federal Procurement Regulations* was designated primarily for commercial firms, and is not necessarily well suited to nonprofit organizations. At the suggestion of the General Accounting Office, the nonprofit cost principles were written to conform as closely as possible to those of educational institutions (Circular A–21), and State and local governments (Circular 74–4).

John J. Lordan,

Chief, Financial Management Branch.

[Circular No. A–122]

June 27, 1980

To The Heads of Executive Departments and Establishments

Subject: Cost principles for nonprofit organizations.

1. *Purpose.* This Circular establishes principles for determining costs of grants, contracts and other agreements with nonprofit organizations. It does not apply to colleges and universities which are covered by Circular A–21; State, local, and federally recognized Indian tribal governments which are covered by Circular 74–4; or hospitals. The principles are designed to provide that the Federal Government bear its fair share of costs except where restricted or prohibited by law. The principles do not attempt to prescribe the extent of cost sharing or matching on grants, contracts, or other agreements. However, such cost sharing or matching shall not be accomplished through arbitrary limitations on individual cost elements by Federal agencies. Provision for profit or other increment above cost is outside the scope of this Circular.

2. *Supersession.* This Circular supersedes cost principles issued by individual agencies for nonprofit organization.

3. *Applicability.* a. These principles shall be used by all Federal agencies in determining the costs of work performed by nonprofit organizations under grants, cooperative agreements, cost reimbursement contracts, and other contracts in which costs are used in pricing, administration, or settlement. All of these instruments are hereafter referred to as awards. The principles do not apply to awards under which an organization is not required to account to the Government for actual costs incurred.

b. All cost reimbursement subawards (subgrants, subcontracts, etc.) are subject to those Federal cost principles applicable to the particular organization concerned. Thus, if a subaward is to a nonprofit organization, this Circular shall apply; if a subaward is to a commercial organization, the cost principles applicable to commercial concerns shall apply; if a subaward is to a college or university, Circular A–21 shall apply; if a subaward is to a State, local, or federally recognized Indian tribal government, Circular 74–4 shall apply.

4. *Definitions.* a. *"Nonprofit organization"* means any corporation, trust, association, cooperative, or other organization which (1) is operated primarily for scientific, educational, service, charitable, or similar purposes in the public interest; (2) is not organized primarily for profit; and (3) uses its net proceeds to maintain, improve, and/or expand its operations. For this purpose, the term "nonprofit organization" excludes (i) colleges and universities; (ii) hospitals; (iii) State, local, and federally recognized Indian tribal governments; and (iv) those nonprofit organizations which are excluded from coverage of this Circular in accordance with paragraph 5 below.

b. *"Prior approval"* means securing the awarding agency's permission in advance to incur cost for those items that are designated as requiring prior approval by the Circular. Generally this permission will be in writing. Where an item of cost requiring prior approval is specified in the budget of an award, approval of the budget constitutes approval of that cost.

5. *Exclusion of some nonprofit organizations.* Some nonprofit organizations, because of their size and nature of operations, can be considered to be similar to commercial concerns for purpose of applicability of cost principles. Such nonprofit organizations shall operate under Federal cost principles applicable to commercial concerns. A listing of these

organizations is contained in Attachment C. Other organizations may be added from time to time.

6. *Responsibilities.* Agencies responsible for administering programs that involve awards to nonprofit organizations shall implement the provisions of this Circular. Upon request, implementing instruction shall be furnished to the Office of Management and Budget. Agencies shall designate a liaison official to serve as the agency representative on matters relating to the implementation of this Circular. The name and title of such representative shall be furnished to the Office of Management and Budget within 30 days of the date of this Circular.

7. *Attachments.* The principles and related policy guides are set forth in the following Attachments:

Attachment A—General Principles
Attachment B—Selected Items of Cost
Attachment C—Nonprofit Organizations Not Subject to This Circular

8. *Requests for exceptions.* The Office of Management and Budget may grant exceptions to the requirements of this Circular when permissible under existing law. However, in the interest of achieving maximum uniformity, exceptions will be permitted only in highly unusual circumstances.

9. *Effective Date.* The provisions of this Circular are effective immediately. Implementation shall be phased in by incorporating the provisions into new awards made after the start of the organization's next fiscal year. For existing awards the new principles may be applied if an organization and the cognizant Federal agency agree. Earlier implementation, or a delay in implementation of individual provisions is also permitted by mutual agreement between an organization and the cognizant Federal agency.

10. *Inquiries.* Further information concerning this Circular may be obtained by contacting the Financial Management Branch, Budget Review Division, Office of Management and Budget, Washington, D.C. 20503, telephone (202) 395-4773.

James T. McIntyre, Jr.,
Director.

[Circular No. A-122]

Attachment A

General Principles

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[Circular No. A-122]

Attachment A

General Principles

A. Basic Considerations.

1. *Composition of total costs.* The total cost of an award is the sum of the allowable direct and allocable indirect costs less any applicable credits.

2. *Factors affecting allowability of costs.* To be allowable under an award, costs must meet the following general criteria:

a. Be reasonable for the performance of the award and be allocable thereto under these principles.

b. Conform to any limitations or exclusions set forth in these principles or in the award as to types or amount of cost items.

c. Be consistent with policies and procedures that apply uniformly to both federally financed and other activities of the organization.

d. Be accorded consistent treatment.

e. Be determined in accordance with generally accepted accounting principles.

f. Not be included as a cost or used to meet cost sharing or matching requirements of any other federally financed program in either the current or a prior period.

g. Be adequately documented.

3. *Reasonable costs.* A cost is 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 the decision was made to incur the costs. The question of the reasonableness of specific costs must be scrutinized with particular care in connection with organizations or separate divisions thereof which receive the preponderance of their support from awards made by Federal agencies. In determining the reasonableness of a given cost, consideration shall be given to:

a. Whether the cost is of a type generally recognized as ordinary and necessary for the operation of the organization or the performance of the award.

b. The restraints or requirements imposed by such factors as generally accepted sound business practices, arms length bargaining, Federal and State laws and regulations, and terms and conditions of the award.

c. Whether the individuals concerned acted with prudence in the circumstances, considering their responsibilities to the organization, its members, employees, and clients, the public at large, and the Government.

d. Significant deviations from the established practices of the organization which may unjustifiably increase the award costs.

4. *Allocable costs.*

a. A cost is allocable to a particular cost objective, such as a grant, project, service, or other activity, in accordance with the relative benefits received. A cost is allocable to a Government award if it is treated consistently with other costs incurred for the same purpose in like circumstances and if it:

(1) Is incurred specifically for the award.

(2) Benefits both the award and other work and can be distributed in reasonable proportion to the benefits received, or

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

b. Any cost allocable to a particular award or other cost objective under these principles may not be shifted to other Federal awards to overcome funding deficiencies, or to avoid restrictions imposed by law or by the terms of the award.

5. *Applicable credits.*

a. The term applicable credits refers to those receipts, or reduction of expenditures which operate to offset or reduce expense items that are allocable to awards as direct or indirect costs. Typical examples of such transactions are: purchase discounts, rebates or allowances, recoveries or indemnities on losses, insurance refunds, and adjustments of overpayments or erroneous charges. To the extent that such credits accruing or received by the organization relate to allowable cost they shall be credited to the Government either as a cost reduction or cash refund as appropriate.

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

(c) For rules covering program income (i.e., gross income earned from federally supported activities) see Attachment D of OMB Circular A-110.

6. *Advance understandings.* Under any given award the reasonableness and allocability of certain items of costs may be difficult to determine. This is particularly true in connection with organizations that receive a preponderance of their support from Federal agencies. In order to avoid subsequent disallowance or dispute based on unreasonableness or nonallocability, it is often desirable to seek a written agreement with the cognizant or awarding agency in advance of the incurrence of special or unusual costs. The absence of an advance agreement on any element of cost will not, in itself, affect the reasonableness or allocability of that element.

B. Direct Costs

1. Direct costs are those that can be identified specifically with a particular final cost objective: i.e., a particular award, project, service, or other direct activity of an organization. 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.

2. 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.

3. The cost of certain activities are not allowable as charges to Federal awards (see, for example, fund raising costs in paragraph 19 of Attachment B). However, even though these costs are unallowable for purposes of computing charges to Federal awards, they nonetheless must be treated as direct cost for purposes of determining indirect cost rates and be allocated their share of the organization's indirect costs if they represent activities which (1) include the salaries of personnel, (2) occupy space, and (3) benefit from the organization's indirect costs.

4. The costs of activities performed primarily as a service to members, clients, or the general public when significant and necessary to the organization's mission must be treated as direct costs whether or not allowable and be allocated an equitable share of indirect costs. Some examples of these types of activities include:

a. Maintenance of membership rolls, subscriptions, publications, and related functions.

b. Providing services and information to members, legislative or administrative bodies, or the public.

c. Promotion, lobbying, and other forms of public relations.

d. Meetings and conferences except those held to conduct the general administration of the organization.

3. Maintenance, protection, and investment of special funds not used in operation of the organization.

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

C. Indirect Cost.

1. Indirect costs are those that have been incurred for common or joint objectives and cannot be readily identified with a particular final cost objective. Direct cost of minor amounts may be treated as indirect costs under the conditions described in paragraph B.2. above. After direct costs have been determined and assigned directly to awards or other work 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, has been assigned to an award as a direct cost.

2. Because of the diverse characteristics and accounting practices of nonprofit organizations, it is not possible to specify the types of costs which may be classified as indirect cost in all situations. However, typical examples of indirect cost for many nonprofit organizations may include depreciation or use allowances on buildings and equipment, the costs of operating and maintaining facilities, and general administration and general expenses, such as the salaries and expenses of executive officers, personnel administration, and accounting.

D. Allocation of Indirect Costs and Determination of Indirect Cost Rates.

1. *General.*

a. Where a nonprofit organization has only one major function, or where all its major functions benefit from its indirect costs to approximately the same degree, the allocation of indirect costs and the computation of an indirect cost rate may be accomplished through simplified allocation procedures as described in paragraph 2 below.

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

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

d. Specific methods for allocating indirect costs and computing indirect cost rates along with the conditions under which each method should be used are described in paragraphs 2 through 5 below.

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

2. *Simplified allocation method.*

a. Where an organization's major functions benefit from its indirect costs to approximately the same degree, the allocation of indirect costs may be accomplished by (i) separating the organization's total costs for the base period as either direct or indirect, and (ii) dividing the total allowable indirect costs (net of applicable credits) by an equitable distribution base. The result of this process is an indirect cost rate which is used to distribute indirect costs to individual awards. The rate should be expressed as the percentage which the total amount of allowable indirect costs bears to the base selected. This method should also be used where an organization has only one major function encompassing a number of individual projects or activities, and may be used where the level of Federal awards to an organization is relatively small.

b. Both the direct costs and the indirect costs shall exclude capital expenditures and unallowable costs. However, unallowable costs which represent activities must be included in the direct costs under the conditions described in paragraph B.3. above.

c. The distribution base may be total direct costs (excluding capital expenditures and other distorting items, such as major subcontracts or subgrants), direct salaries and wages, or other base which results in an equitable distribution. The distribution base shall generally exclude participant support costs as defined in paragraph 29 of Attachment B.

d. Except where a special rate(s) is required in accordance with paragraph D.5 below, the indirect cost rate developed under the above principles is applicable to all awards at the organization. If a special rate(s) is required, appropriate modifications shall be made in order to develop the special rate(s).

3. *Multiple allocation base method.*

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

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

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

d. Except where a special indirect cost rate(s) is required in accordance with

paragraph D.5 below, the separate groupings of indirect costs allocated to each major function shall be aggregated and treated as a common pool for that function. The costs in the common pool shall then be distributed to individual awards included in that function by use of a single indirect cost rate.

e. The distribution base used in computing the indirect cost rate for each function may be total direct costs (excluding capital expenditures and other distorting items such as major subcontracts and subgrants), direct salaries and wages, or other base which results in an equitable distribution. The distribution base shall generally exclude participant support costs as defined in paragraph 29, Attachment B. An indirect cost rate should be developed for each separate indirect cost pool developed. The rate in each case should be stated as the percentage which the amount of the particular indirect cost pool is of the distribution base identified with that pool.

4. *Direct allocation method.*

a. Some nonprofit organizations, treat all costs as direct costs except general administration and general expenses. These organizations generally separate their costs into three basic categories: (i) General administration and general expenses, (ii) fund raising, and (iii) other direct functions (including projects performed under Federal awards). Joint costs, such as depreciation, rental costs, operation and maintenance of facilities, telephone expenses, and the like are prorated individually as direct costs to each category and to each award or other activity using a base most appropriate to the particular cost being prorated.

b. This method is acceptable provided each joint cost is prorated using a base which accurately measures the benefits provided to each award or other activity. The bases must be established in accordance with reasonable criteria, and be supported by current data. This method is compatible with the Standards of Accounting and Financial Reporting for Voluntary Health and Welfare Organizations issued jointly by the National Health Council, Inc., the National Assembly of Voluntary Health and Social Welfare Organizations, and the United Way of America.

c. Under this method, indirect costs consist exclusively of general administration and general expenses. In all other respects, the organization's indirect cost rates shall be computed in the same manner as that described in paragraph D.2 above.

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

E. Negotiation and Approval of Indirect Cost Rates.

1. *Definitions.* As used in this section, the following terms have the meanings set forth below:

a. "Cognizant agency" means the Federal agency responsible for negotiating and approving indirect cost rates for a nonprofit organization on behalf of all Federal agencies.

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

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

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

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

f. "Indirect cost proposal" means the documentation prepared by an organization to substantiate its claim for the reimbursement of indirect costs. This proposal provides the basis for the review and negotiation leading to the establishment of an organization's indirect cost rate.

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

2. *Negotiation and approval of rates.*

a. Unless different arrangements are agreed to by the agencies concerned, the Federal agency with the largest dollar value of awards with an organization will be designated as the cognizant agency for the negotiation and approval of indirect cost rates and, where necessary, other rates such as fringe benefit and computer charge-out rates. Once an agency is assigned cognizance for a particular nonprofit organization, the assignment will not be changed unless there is a major long-term shift in the dollar volume of the Federal awards to the organization. All concerned Federal agencies shall be given the opportunity to participate in the negotiation process, but after a rate has been agreed upon it will be accepted by all Federal agencies. When a Federal agency has reason to believe that special operating factors affecting its awards necessitate special indirect cost rates in accordance with paragraph D.5 above, it will, prior to the time the rates are negotiated, notify the cognizant agency.

b. A nonprofit organization which has not previously established an indirect cost rate with a Federal agency shall submit its initial indirect cost proposal to the cognizant agency. The proposal shall be submitted as soon as possible after the organization is advised that an award will be made and, in no event, later than three months after the effective date of the award.

c. Organizations that have previously established indirect cost rates must submit a new indirect cost proposal to the cognizant agency within six months after the close of each fiscal year.

d. A predetermined rate may be negotiated for use on awards where there is reasonable assurance, based on past experience and reliable projection of the organization's costs, that the rate is not likely to exceed a rate based on the organization's actual costs.

e. Fixed rates may be negotiated where predetermined rates are not considered appropriate. A fixed rate, however, shall not be negotiated if (i) all or a substantial portion of the organization's awards are expected to expire before the carry-forward adjustment can be made; (ii) the mix of Government and non-government work at the organization is too erratic to permit an equitable carry-forward adjustment; or (iii) the organization's operations fluctuate significantly from year to year.

f. Provisional and final rates shall be negotiated where neither predetermined nor fixed rates are appropriate.

g. The results of each negotiation shall be formalized in a written agreement between the cognizant agency and the nonprofit organization. The cognizant agency shall distribute copies of the agreement to all concerned Federal agencies.

h. If a dispute arises in a negotiation of an indirect cost rate between the cognizant agency and the nonprofit organization, the dispute shall be resolved in accordance with the appeals procedures of the cognizant agency.

i. To the extent that problems are encountered among the Federal agencies in connection with the negotiation and approval process, the Office of Management and Budget will lend assistance as required to resolve such problems in a timely manner.

(Circular No. A-122)

Attachment B

Selected Items of Cost

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[Circular No. A-122]

Attachment B

Selected Items of Cost

Paragraphs 1 through 50 provide principles to be applied in establishing the allowability of certain items of cost. These principles apply whether a cost is treated as direct or indirect. Failure to mention a particular item of cost is not intended to imply that it is unallowable; rather determination as to allowability in each case should be based on the treatment or principles provided for similar or related items of cost.

1. *Advertising costs.*

a. Advertising costs mean the costs of *media services and associated costs. Media* advertising includes magazines, newspapers, radio and television programs, direct mail, exhibits, and the like.

b. The only advertising costs allowable are those which are solely for (i) the recruitment of personnel when considered in conjunction with all other recruitment costs, as set forth in paragraph 40; (ii) the procurement of goods and services; (iii) the disposal of surplus materials acquired in the performance of the award except when organizations are reimbursed for disposals at a predetermined amount in accordance with Attachment N of OMB Circular A-110; or (iv) specific requirements of the award.

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

3. *Bid and proposal costs.* (reserved)

4. *Bonding costs.*

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

b. Costs of bonding required pursuant to the terms of the award are allowable.

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

5. *Communication costs.* Costs incurred for telephone services, local and long distance telephone calls, telegrams, radiograms, postage and the like, are allowable.

6. *Compensation for personal services.*

a. *Definition.* Compensation for personal services includes all compensation paid currently or accrued by the organization for services of employees rendered during the period of the award (except as otherwise provided in paragraph g. below). It includes, but is not limited to, salaries, wages, director's and executive committee member's fees, incentive awards, fringe benefits, pension plan costs, allowances for off-site pay, incentive pay, location allowances, hardship pay, and cost of living differentials.

b. *Allowability.* Except as otherwise specifically provided in this paragraph, the *costs of such compensation are allowable to* the extent that:

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

(2) Charges to awards whether treated as direct or indirect costs are determined and supported as required in this paragraph.

c. *Reasonableness.*

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

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

d. *Special considerations in determining allowability.* Certain conditions require special consideration and possible limitations in determining costs under Federal awards where amounts or types of compensation appear unreasonable. Among such conditions are the following:

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

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

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

f. *Fringe benefits.*

(1) Fringe benefits in the form of regular compensation paid to employees during periods of authorized absences from the job, such as vacation leave, sick leave, military leave, and the like, are allowable provided such costs are absorbed by all organization activities in proportion to the relative amount of time or effort actually devoted to each.

(2) Fringe benefits in the form of employer contributions or expenses for social security, employee insurance, workmen's compensation insurance, pension plan costs (see paragraph g. below), and the like, are allowable provided such benefits are granted in accordance with established written organization policies. Such benefits whether treated as indirect costs or as direct costs, shall be distributed to particular awards and other activities in a manner consistent with the pattern of benefits accruing to the individuals or group of employees whose salaries and wages are chargeable to such awards and other activities.

(3)(a) Provisions for a reserve under a self-insurance program for unemployment compensation or workers' compensation are allowable to the extent that the provisions represent reasonable estimates of the liabilities for such compensation, and the types of coverage, extent of coverage, and rates and premiums would have been allowable had insurance been purchased to cover the risks. However, provisions for self-insured liabilities which do not become payable for more than one year after the provision is made shall not exceed the present value of the liability.

(b) Where an organization follows a consistent policy of expensing actual payments to, or on behalf of, employees or former employees for unemployment compensation or workers' compensation, such payments are allowable in the year of payment with the prior approval of the awarding agency provided they are allocated to all activities of the organization.

(4) Costs of insurance on the lives of trustees, officers, or other employees holding positions of similar responsibility are allowable only to the extent that the insurance represents additional compensation. The costs of such insurance when the organization is named as beneficiary are unallowable.

g. *Pension plan costs.*

(1) Costs of the organization's pension plan which are incurred in accordance with the established policies of the organization are allowable, provided:

(a) Such policies meet the test of reasonableness;

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

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

(d) The costs assigned to a given fiscal year are funded for all plan participants within six months after the end of that year. However, increases to normal and past service pension costs caused by a delay in funding the actuarial liability beyond 30 days after each quarter of the year to which such costs are assignable are unallowable.

(2) Pension plan termination insurance premiums paid pursuant to the Employee Retirement Income Security Act of 1974 (Pub. L. 93-406) are allowable. Late payment charges on such premiums are unallowable.

(3) Excise taxes on accumulated funding deficiencies and other penalties imposed under the Employee Retirement Income Security Act are unallowable.

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

i. *Overtime, extra pay shift, and multishift premiums.* See paragraph 27.

j. *Severance pay.* See paragraph 44.

k. *Training and education costs.* See paragraph 48.

l. *Support of salaries and wages.*

(1) Charges to awards for salaries and wages, whether treated as direct costs or indirect costs, will be based on documented payrolls approved by a responsible official(s) of the organization. The distribution of salaries and wages to awards must be supported by personnel activity reports as prescribed in subparagraph (2) below, except when a substitute system has been approved in writing by the the cognizant agency. (See paragraph E.2 of Attachment A)

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

(a) The reports must reflect an *after-the-fact* determination of the actual activity of each employee. Budget estimates (i.e., estimates determined before the services are performed) do not qualify as support for charges to awards.

(b) Each report must account for the total activity for which employees are compensated and which is required in fulfillment of their obligations to the organization.

(c) The reports must be signed by the individual employee, or by a responsible supervisory official having first hand knowledge of the activities performed by the employee, that the distribution of activity represents a reasonable estimate of the actual work performed by the employee during the periods covered by the reports.

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

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

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

7. *Contingency provisions.* Contributions to a contingency reserve or any similar provision made for events the occurrence of which cannot be foretold with certainty as to time, intensity, or with an assurance of their happening, are unallowable. The term "contingency reserve" excludes self-insurance reserves (see paragraph 8.f.(3) and 18.a.(2)(d)); pension funds (see paragraph 6.(g)); and reserves for normal severance pay (see paragraph 44.(b)(1).

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

9. *Depreciation and use allowances.*

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

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

c. The computation of use allowances or depreciation will exclude:

(1) The cost of land;

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

(3) Any portion of the cost of buildings and equipment contributed by or for the organization in satisfaction of a statutory matching retirement.

d. Where the use allowance method is followed, the use allowance for buildings and improvement (including land improvements such as paved parking areas, fences, and sidewalks) will be computed at an annual rate not exceeding two percent of acquisition cost. The use allowance for equipment will be computed at an annual rate not exceeding six and two-thirds percent of acquisition cost. When the use allowance method is used for buildings, the entire building must be treated as a single asset; the building's components (e.g. plumbing system, heating and air conditioning, etc.) cannot be segregated from the building's shell. The two percent limitation, however, need not be applied to equipment which is merely attached or fastened to the building but not permanently fixed to it and which is used as furnishings or decorations or for specialized purposes (e.g., dentist chairs and dental treatment units, counters, laboratory benches bolted to the floor, dishwashers, carpeting, etc.). Such equipment will be considered as not being permanently fixed to the building if it can be removed without the need for costly or extensive alterations or repairs to the building or the equipment. Equipment that meets these criteria will be subject to the six and two-thirds percent equipment use allowance limitation.

e. Where depreciation method is followed, the period of useful service (useful life) established in each case for usable capital assets must take into consideration such factors as type of construction, nature of the equipment used, technological developments in the particular program area, and the renewal and replacement policies followed for the the individual items or classes of assets involved. The method of depreciation used to assign the cost of an asset (or group of assets) to accounting periods shall reflect the pattern of consumption of the asset during its useful life. In the absence of clear evidence indicating that the expected consumption of the asset will be significantly greater or lesser in the early portions of its

useful life than in the later portions, the straight-line method shall be presumed to be the appropriate method. Depreciation methods once used shall not be changed unless approved in advance by the cognizant Federal agency. When the depreciation method is introduced for application to assets previously subject to a use allowance, the combination of use allowances and depreciation applicable to such assets must not exceed the total acquisition cost of the assets. When the depreciation method is used for buildings, a building's shell may be segregated from each building component (e.g., plumbing system, heating, and air conditioning system, etc.) and each item depreciated over its estimated useful life; or the entire building (i.e., the shell and all components) may be treated as a single asset and depreciated over a single useful life.

f. When the depreciation method is used for a particular class of assets, no depreciation may be allowed on any such assets that, under paragraph e. above, would be viewed as fully depreciated. However, a reasonable use allowance may be negotiated for such assets if warranted after taking into consideration the amount of depreciation previously charged to the Government, the estimated useful life remaining at time of negotiation, the effect of any increased maintenance charges or decreased efficiency due to age, and any other factors pertinent to the utilization of the asset for the purpose contemplated.

g. Charges for use allowances or depreciation must be supported by adequate property records and physical inventories must be taken at least once every two years (a statistical sampling basis is acceptable) to ensure that assets exist and are usable and needed. When the depreciation method is followed, adequate depreciation records indicating the amount of depreciation taken each period must also be maintained.

10. *Donations*

a. *Services received.*

(1) Donated or volunteer services may be furnished to an organization by professional and technical personnel, consultants, and other skilled and unskilled labor. The value of these services is not reimbursable either as a direct or indirect cost.

(2) The value of donated services utilized in the performance of a direct cost activity shall be considered in the determination of the organization's indirect cost rate(s) and, accordingly, shall be allocated a proportionate share of applicable indirect costs when the following circumstances exist:

(a) The aggregate value of the services is material;

(b) The services are supported by a significant amount of the indirect costs incurred by the organization;

(c) The direct cost activity is not pursued primarily for the benefit of the Federal Government.

(3) In those instances where there is no basis for determining the fair market value of the services rendered, the recipient and the cognizant agency shall negotiate an appropriate allocation of indirect cost to the services.

(4) Where donated services directly benefit a project supported by an award, the indirect costs allocated to the services will be considered as a part of the total costs of the project. Such indirect costs may be reimbursed under the award or used to meet cost sharing or matching requirements.

(5) The value of the donated services may be used to meet cost sharing or matching requirements under conditions described in Attachment E, OMB Circular No. A-110. Where donated services are treated as indirect costs, indirect cost rates will separate the value of the donations so that *reimbursement will not be made.*

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

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

(b) *Services donated by other organizations.* When an employer donates the services of an employee, these services shall be valued at the employee's regular rate of pay (exclusive of fringe benefits and indirect costs) provided the services are in the same skill for which the employee is normally paid. If the services are not in the same skill for which the employee is normally paid, fair market value shall be computed in accordance with subparagraph (a) above.

b. *Goods and space.*

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

(2) The value of the donations may be used to meet cost sharing or matching share requirements under the conditions described in Attachment E, OMB Circular No. A-110. The value of the donations shall be determined in accordance with Attachment E. Where donations are treated as indirect costs, indirect cost rates will separate the value of the donations so that reimbursement will not be made.

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

12. *Entertainment costs.* Costs of amusement, diversion, social activities, ceremonials, and costs relating thereto, such as meals, lodging, rentals, transportation, and gratuities are unallowable (but see paragraphs 11 and 25).

13. *Equipment and other capital expenditures.*

a. As used in this paragraph, the following terms have the meanings set forth below:

(1) "Equipment" means an article of nonexpendable tangible personal property having a useful life of more than two years and an acquisition cost of $500 or more per unit. An organization may use its own definition provided that it at least includes all nonexpendable tangible personal property as defined herein.

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

(3) "Special purpose equipment" means equipment which is usable only for research, medical, scientific, or technical activities. Examples of special purpose equipment include microscopes, x-ray machines, surgical instruments, and spectrometers.

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

b. (1) Capital expenditures for general purpose equipment are unallowable as a direct cost except with the prior approval of the awarding agency.

(2) Capital expenditures for special purpose equipment are allowable as direct costs provided that items with a unit cost of $1000 or more have the prior approval of the awarding agency.

c. Capital expenditures for land or buildings are unallowable as a direct cost except with the prior approval of the awarding agency.

d. Capital expenditures for improvements to land, buildings, or equipment which materially increase their value or useful life are unallowable as a direct cost except with the prior approval of the awarding agency.

e. Equipment and other capital expenditures are unallowable as indirect costs. However, see paragraph 9 for allowability of use allowances or depreciation on buildings, capital improvements, and equipment. Also, see paragraph 42 for allowability of rental costs for land, buildings, and equipment.

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

15. *Fringe benefits.* See paragraph 6. f.

16. *Idle facilities and idle capacity.*

a. As used in this paragraph the following terms have the meanings set forth below:

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

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

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

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

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

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

(2) Although not necessary to meet fluctuations in workload, they were necessary when acquired and are now idle because of changes in program requirements, efforts to achieve more economical operations, reorganization, termination, or other causes which could not have been reasonably foreseen. Under the exception stated in this subparagraph, costs of idle facilities are allowable for a reasonable period of time, ordinarily not to exceed one year, depending upon the initiative taken to use, lease, or dispose of such facilities (but see paragraphs 47.o. and d.).

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

17. *Independent research and development* [Reserved].

18. *Insurance and indemnification.*

a. Insurance includes insurance which the organization is required to carry, or which is approved, under the terms of the award and any other insurance which the organization maintains in connection with the general conduct of its operations. This paragraph does not apply to insurance which represents fringe benefits for employees (see paragraph 6.f. and 6.g.(2)).

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

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

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

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

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

(d) Provisions for a reserve under a self-insurance program are allowable to the extent that types of coverage, extent of coverage, rates, and premiums would have been allowed had insurance been purchased to cover the risks. However, provision for known or reasonably estimated self-insured liabilities, which do not become payable for more than one year after the provision is made shall not exceed the present value of the liability.

(e) Costs of insurance on the lives of trustees, officers, or other employees holding positions of similar responsibilities are allowable only to the extent that the insurance represents additional compensation (see paragraph 6). The cost of such insurance when the organization is identified as the beneficiary is unallowable.

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

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

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

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

19. *Interest, fund raising, and investment management costs.*

a. Costs incurred for interest on borrowed capital or temporary use of endowment funds, however represented, are unallowable.

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

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

d. Fund raising and investment activities shall be allocated an appropriate share of indirect costs under the conditions described in paragraph B of Attachment A.

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

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

22. *Maintenance and repair costs.* Costs incurred for necessary maintenance, repair, or upkeep of buildings and equipment (including Government property unless otherwise provided for) which neither add to the permanent value of the property nor appreciably prolong its intended life, but keep it in an efficient operating condition, are allowable. Costs incurred for improvements which add to the permanent value of the buildings and equipment or appreciably prolong their intended life shall be treated as capital expenditures (see paragraph 13).

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

24. *Meetings, conferences.*

a. Costs associated with the conduct of meetings and conferences, include the cost of renting facilities, meals, speakers' fees, and the like. But see paragraph 12, *Entertainment costs*, and paragraph 29, *Participant support costs.*

b. To the extent that these costs are identifiable with a particular cost objective, they should be charged to that objective. (See paragraph B. of Attachment A.) These costs are allowable provided that they meet the general tests of allowability, shown in Attachment A to this Circular.

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

25. *Memberships, subscriptions, and professional activity costs.*

a. Costs of the organization's membership in civic, business, technical and professional organizations are allowable.

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

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

26. *Organization costs.* Expenditures, such as incorporation fees, brokers' fees, fees to promoters, organizers or management consultants, attorneys, accountants, or

investment counselors, whether or not employees of the organization, in connection with establishment or reorganization of an organization, are unallowable except with prior approval of the awarding agency.

27. *Overtime, extra-pay shift, and multishift premiums.* Premiums for overtime, extra-pay shifts, and multishift work are allowable only with the prior approval of the awarding agency except:

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

b. When employees are performing indirect functions such as administration, maintenance, or accounting.

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

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

28. *Page charges in professional journals.* Page charges for professional journal publications are allowable as a necessary part of research costs, where:

a. The research papers report work supported by the Government; and

b. The charges are levied impartially on all research papers published by the journal, whether or not by Government-sponsored authors.

29. *Participant support costs.* Participant support costs are direct costs for items such as stipends or subsistence allowances, travel allowances, and registration fees paid to or on behalf of participants or trainees (but not employees) in connection with meetings, conferences, symposia, or training projects. These costs are allowable with the prior approval of the awarding agency.

30. *Patent costs.*

a. Costs of (i) preparing disclosures, reports, and other documents required by the award and of searching the art to the extend necessary to make such disclosures, (ii) preparing documents and any other patent costs in connection with the filing and prosecution of a United states patent application where title or royalty-free license is required by the Government to be conveyed to the Government, and (iii) general counseling services relating to patent and copyright matters, such as advice on patent and copyright laws, regulations, clauses, and employee agreements are allowable (but see paragraph 34).

b. Cost of preparing disclosures, reports, and other documents and of searching the art to the extent necessary to make disclosures, if not required by the award, are unallowable. Costs in connection with (i) filing and prosecuting any foreign patent application, or (ii) any United States patent application, where the award does not require conveying title or a royalty-free license to the Government, are unallowable (also see paragraph 43).

31. *Pension plans.* See paragraph 6. g.

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

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

34. *Professional service costs.*

a. Costs of professional and consultant services rendered by persons who are members of a particular profession or possess a special skill, and who are not officers or employees of the organization, are allowable, subject to b, c, and d. of this paragraph when reasonable in relation to the services rendered and when not contingent upon recovery of the costs from the Government.

b. In determing the allowability of costs in a particular case, no single factor or any special combination of factors is necessarily determinative. However, the following factors are relavant:

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

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

(3) The past pattern of such costs, particularly in the years prior to Government awards.

(4) The impact of Government awards on the organization's business (i.e., what new problems have arisen).

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

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

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

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

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

d. Cost of legal, accounting, and consulting services, and related costs incurred in connection with defense of antitrust suits, and the prosecution of claims against the Government, are unallowable. Costs of legal, accounting and consulting services, and related costs, incurred in connection with patent infringement litigation, organization and reorganization, are unallowable unless otherwise provided for in the award (but see paragraph 47e).

35. *Profits and losses on disposition of depreciable property or other capital assets.*

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

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

(a) The gain or loss is processed through a depreciation reserve account and is reflected in the depreciation allowable under paragraph 9.

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

(c) A loss results from the failure to maintain permissible insurance, except as otherwise provided in paragraph 18.a.(3).

(d) Compensation for the use of the property was provided through use allowances in lieu of depreciation in accordance with paragraph 9.

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

b. Gains or losses of any nature arising from the sale or exchange of property other than the property covered in paragraph a. above shall be excluded in computing award costs.

36. *Public information service costs.*

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

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

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

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

b. Public information service costs are allowable as direct costs with the prior approval of the awarding agency. Such costs are unallowable as indirect costs.

37. *Publication and printing costs.*

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

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

c. Publication and printing costs are unallowable as direct costs except with the prior approval of the awarding agency.

d. The cost of page charges in journals is addressed paragraph 28.

38 *Rearrangement and alteration costs.* Costs incurred for ordinary or normal rearrangement and alteration of facilities are allowable. Special arrangement and alteration costs incurred specifically for the project are allowable with the prior approval of the awarding agency.

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

40. *Recruiting costs.* The following recruiting costs are allowable: cost of "help wanted" advertising, operating costs of an employment office, costs of operating an educational testing program, travel expenses including food and lodging of employees while engaged in recruiting personnel, travel costs of applicants for interviews for prospective employment, and relocation costs incurred incident to recruitment of new employees (see paragraph 41c). Where the organization uses employment agencies, costs not in excess of standard commercial rates for such services are allowable.

41. *Relocation costs.*

a. Relocation costs are costs incident to the permanent change of duty assignment (for an indefinite period or for a stated period of not less than 12 months) of an existing employee or upon recruitment of a new employee. Relocation costs are allowable, subject to the limitation described in paragraphs b, c, and d, below, provided that:

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

(2) Reimbursement to the employee is in accordance with an established written policy consistently followed by the employer.

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

b. Allowable relocation costs for current employees are limited to the following:

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

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

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

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

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

c. Allowable relocation costs for new employees are limited to those described in (1) and (2) of paragraph b. above. When relocation costs incurred incident to the recruitment of new employees have been allowed either as a direct or indirect cost and the employee resigns for reasons within his control within 12 months after hire, the organization shall refund or credit the Government for its share of the cost. However, the costs of travel to an overseas location shall be considered travel costs in accordance with paragraph 50 and not relocation costs for the purpose of this paragraph if dependents are not permitted at the location for any reason and the costs do not include costs of transporting household goods.

d. The following costs related to relocation are unallowable:

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

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

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

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

42. *Rental costs.*

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

b. Rental costs under sale and leaseback arrangements are allowable only up to the amount that would be allowed had the organization continued to own the property.

c. Rental costs under less-than-length leases are allowable only up to the amount that would be allowed had title to the property vested in the organization. For this purpose, a less-than-arms-length lease is one under which one party to the lease agreement is able to control or substantially influence the actions of the other. Such leases include, but are not limited to those between (i) divisions of an organization; (ii) organizations under common control through common officers, directors, or members; and (iii) an organization and a director, trustee, officer, or key employee of the organization or his immediate family either directly or through corporations, trusts, or similar arrangements in which they hold a controlling interest.

d. Rental costs under leases which create a material equity in the leased property are allowable only up to the amount that would be allowed had the organization purchased the property on the date the lease agreement was executed; e.g., depreciation or use allowances, maintenance, taxes, insurance but excluding interest expense and other unallowable costs. For this purpose, a material equity in the property exists if the lease in noncancelable or is cancelable only upon the occurrence of some remote contingency and has one or more of the following characteristics:

(1) The organization has the right to purchase the property for a price which at the beginning of the lease appears to be substantially less than the probable fair market value at the time it is permitted to purchase the property (commonly called a lease with a bargain purchase option);

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

(3) The term of the lease (initial term plus periods covered by bargain renewal options, if any) is equal to 75 per cent or more of the economic life of the leased property; i.e., the period the property is expected to be economically usable by one or more users.

43. *Royalties and other costs for use of patents and copyrights.*

a. Royalties on a patent or copyright or amortization of the cost of acquiring by purchase a copyright, patent, or rights thereto, necessary for the proper performance of the award are allowable unless:

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

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

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

(4) The patent or copyright is expired.

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

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

(2) Royalties paid to unaffiliated parties, including corporations, under an agreement entered into in contemplation that a Government award would be made.

(3) Royalties paid under an agreement entered into after an award is made to an organization.

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

44. *Severance pay.*

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

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

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

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

45. *Specialized service facilities.*

a. The costs of services provided by highly complex or specialized facilities operated by

the organization, such as electronic computers and wind tunnels, are allowable provided the charges for the services meet the conditions of either b. or c. of this paragraph and, in addition, take into account any items of income or Federal financing that qualify as applicable credits under paragraph A.5. of Attachment A.

b. The costs of such services, when material, must be charged directly to applicable awards based on actual usage of the services on the basis of a schedule of rates or established methodology that (i) does not discriminate against federally supported activities of the organization, including usage by the organization for internal purposes, and (ii) is designed to recover only the aggregate costs of the services. The costs of each service shall consist normally of both its direct costs and its allocable share of all indirect costs. Advance agreements pursuant to paragraph A.6. of Attachment A are particularly important in this situation.

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

46. *Taxes.*

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

b. Any refund of taxes, and any payment to the organization of interest thereon, which were allowed as award costs, will be credited either as a cost reduction or cash refund, as appropriate, to the Government.

47. *Termination costs.* Termination of awards generally give rise to the incurrence of costs, or the need for special treatment of costs, which would not have arisen had the award not been terminated. Cost principles covering these items are set forth below. They are to be used in conjunction with the other provisions of this Circular in termination situations.

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

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

c. *Loss of useful value.* Loss of useful value of special tooling, machinery and equipment which was not charged to the award as a capital expenditure is generally allowable if:

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

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

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

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

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

(a) The preparation and presentation to awarding agency of settlement claims and supporting data with respect to the terminated portion of the award, unless the termination is for default. (See paragraph 4.a. of Attachment L, OMB Circular No. A-110; and

(b) The termination and settlement of subawards.

(2) Reasonable costs for the storage, transportation, protection, and disposition of property provided by the Government or acquired or produced for the award: except when grantees are reimbursed for disposals at a predetermined amount in accordance with Attachment N of OMB Circular A-110.

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

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

48. *Training and education costs.*

a. Costs of preparation and maintenance of a program of instruction including but not limited to on-the-job, classroom, and apprenticeship training, designed to increase the vocational effectiveness of employees, including training materials, textbooks, salaries or wages of trainees (excluding overtime compensation which might arise, therefrom), and (i) salaries of the director of training and staff when the training program is conducted by the organization; or (ii) tuition and fees when the training is in an institution not operated by the organization, are allowable.

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

(1) Training materials.

(2) Textbooks.

(3) Fees charges by the educational institution.

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

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

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

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

d. Costs of attendance of up to 10 weeks per employee per year at specialized programs specifically designed to enhance the effectiveness of executives or managers or to prepare employees for such positions are allowable. Such costs include enrollment fees, training materials, textbooks and related charges, employees' salaries, subsistence, and travel. Costs allowable under this paragraph do not include those for courses that are part of a degree-oriented

curriculum, which are allowable only to the extent set forth in b. and c. above.

e. Maintenance expense, and normal depreciation or fair rental, on facilities owned or leased by the organization for training purposes are allowable to the extent set forth in paragraphs 9, 22, and 42.

f. Contributions or donations to educational or training institutions, including the donation of facilities or other properties, and scholarships or fellowships, are unallowable.

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

49. *Transportation costs.* Transportation costs include freight, express, cartage, and postage charges relating either to goods purchased, in process, or delivered. These costs are allowable. When such costs can readily be identified with the items involved, they may be directly charged as transportation costs or added to the cost of such items (see paragraph 23). Where identification with the materials received cannot readily be made, transportation costs may be charged to the appropriate indirect cost accounts if the organization follows a consistent, equitable procedure in this respect.

50. *Travel costs.*

a. Travel costs are the expenses for transportation, lodging, subsistence, and related items incurred by employees who are in travel status on official business of the organization. Travel costs are allowable subject to paragraphs b. through e. below, when they are directly attributable to specific work under an award or are incurred in the normal course of administration of the organization.

b. Such costs may be charged on an actual basis, on a per diem or mileage basis in lieu of actual costs incurred, or on a combination of the two, provided the method used results in charges consistent with those normally allowed by the organization in its regular operations.

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

d. Necessary and reasonable costs of family movements and personnel movements of a special or mass nature are allowable, pursuant to paragraphs 40 and 41, subject to allocation on the basis of work or time period benefited when appropriate. Advance agreements are particularly important.

e. Direct charges for foreign travel costs are allowable only when the travel has received prior approval of the awarding agency. Each separate foreign trip must be approved. For purposes of this provision, foreign travel is defined as any travel outside of Canada and the United States and its territories and possessions. However, for an organization located in foreign countries, the term "foreign travel" means travel outside that country.

[Circular No. A-122]

Attachment C

Nonprofit Organizations not Subject to this Circular

Aerospace Corporation, El Segundo, California
Argonne Universities Association, Chicago, Illinois
Associated Universities, Incorporated, Washington, D.C.
Associated Universities for Research and Astronomy, Tucson, Arizona
Atomic Casualty Commission, Washington, D.C.
Battelle Memorial Institute, Headquartered in Columbus, Ohio
Brookhaven National Laboratory, Upton, New York
Center for Energy and Environmental Research (CEER), (University of Puerto Rico) Commonwealth of Puerto Rico
Charles Stark Draper Laboratory, Incorporated, Cambridge, Massachusetts
Comparative Animal Research Laboratory (CARL)
(University of Tennessee), Oak Ridge, Tennessee
Environmental Institute of Michigan, Ann Arbor, Michigan
Hanford Environmental Health Foundation, Richland, Washington
IIT Research Institute, Chicago, Illinois
Institute for Defense Analysis, Arlington, Virginia
Institute of Gas Technology, Chicago, Illinois
Midwest Research Institute, Headquartered in Kansas City, Missouri
Mitre Corporation, Bedford, Massachusetts
Montana Energy Research and Development Institute, Inc., (MERDI), Butte, Montana
National Radiological Astronomy Observatory, Green Bank, West Virginia
Oak Ridge Associated Universities, Oak Ridge, Tennessee
Project Management Corporation, Oak Ridge, Tennessee
Rand Corporation, Santa Monica, California
Research Triangle Institute, Research Triangle Park, North Carolina
Riverside Research Institute, New York, New York
Sandia Corporation, Albuquerque, New Mexico
Southern Research Institute, Birmingham, Alabama
Southwest Research Institute, San Antonio, Texas
SRI International, Menlo Park, California
Syracuse Research Corporation, Syracuse, New York
Universities Research Association, Incorporated (National Accelerator Lab), Argonne, Illinois
Universities Corporation for Atmospheric Research, Boulder, Colorado
Nonprofit Insurance Companies such as Blue Cross and Blue Shield Organizations
Other nonprofit organizations as negotiated with awarding agencies.

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SAMPLE FORM-CERTIFICATION BY AN AUTHORIZED NONPROFIT ORGANIZATION OFFICIAL

I hereby certify that the information contained in the indirect cost rate proposal for the fiscal year ended or ending _____ and which is attached to this
(Month/Date/Year)
certification is prepared in conformance with Office of Management and Budget Circular A-122. I further certify: (1) that the same costs that have been treated as indirect costs have not been claimed as direct costs, (2) that similar types of costs have been accorded consistent accounting treatment, and (3) that the information provided by the organization which was used as a basis for acceptance of the rate(s) is not subsequently found to be materially inaccurate.

_____
(Signature)

_____
(Name)

_____
(Title)

_____
(Name of Organization)

_____
(Date)