Federal Register

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Part III

Office of Management and Budget

Cost Principles for Educational Institutions; State, Local, and Indian Tribal Governments; and Non-Profit Organizations; Notice

OFFICE OF MANAGEMENT AND BUDGET

Cost Principles for Educational Institutions; State, Local, and Indian Tribal Governments; and Non-Profit Organizations

AGENCY: Office of Management and Budget.

ACTION: Revisions to OMB Circulars A–21, A–87 and A–122.

SUMMARY: The Office of Management and Budget (OMB) amends the cost principles in OMB Circulars A–21, A–87 and A–122. These changes are intended to further the objectives of Public Law 106–107, the Federal Financial Assistance Management Improvement Act, ("the Act"). One of the actions taken by the agencies under the Act was to simplify the cost principles, making the descriptions of similar cost items consistent across the Circulars where possible, and reducing the possibility of misinterpretation.

DATES: These final cost principles are effective June 9, 2004.

ADDRESSES: OMB intends to keep these cost principles current with changes in laws, modifications to accounting standards and advances in technology. If you have comments on ways to improve these principles, please submit your comments to Gilbert Tran, Office of Federal Financial Management, Office of Management and Budget, 725 17th Street, NW., Room 6025, Washington 20503. Due to potential delays in OMB's receipt and processing of mail sent thru the U.S. Postal Service, we encourage you to submit comments electronically to *hai_m._tran@omb.eop.gov* with your name, title, organization and postal address in the text of the message. You may also submit comments via facsimile by sending your comment to (202) 395–4915.

FOR FURTHER INFORMATION CONTACT: Gilbert Tran, Office of Federal Financial Management, Office of Management and Budget, (202) 395–3993.

SUPPLEMENTARY INFORMATION:

Background

The background for this effort was fully described in the preamble to the proposed changes to the circulars, published in the **Federal Register** on August 12, 2002 at 67 FR 52558. Briefly, the Federal Financial Assistance Management Improvement Act of 1999 (Pub. L. 106–107, "the Act") directs the Office of Management and Budget (OMB) and executive branch agencies to simplify and consolidate requirements and procedures for the receipt and administration of financial assistance. Federal financial assistance includes grants, cooperative agreements, loans, loan guarantees, scholarships, and other forms of assistance. The grant and cooperative agreement portion of Federal financial assistance, hereafter referred as "grants," involves more than 600 programs, with awards of more than $400 billion a year, administered by 26 Federal agencies.

Grant recipients deal with increasingly complex problems that require the delivery and coordination of many kinds of services. The support for these services increasingly comes from more than one Federal agency. Grant recipients' need to respond to the numerous Federal grant administration requirements of these agencies and programs only adds to that complexity.

OMB, working with the Department of Health and Human Services as lead agency and the Chief Financial Officers' Council, established an interagency group charged with reviewing the cost principles in Office of Management and Budget Circulars A–21 (A–21), Cost Principles for Educational Institutions, A–87 (A–87), Cost Principles for State, Local and Indian Tribal Governments, and A–122 (A–122), Cost Principles for Non-Profit Organizations. The goal of this group is to ensure that the cost principles in OMB Circulars A–21, A–87, and A–122 are current, consistent, and appropriate for covered recipients. The objectives of the group are to make the descriptions of similar cost items consistent, across the Circulars, where possible, and reduce the possibility of misinterpretation by clarifying existing policies rather than by adding restrictions or modifying current requirements.

Presentation of the Circulars

When we proposed the changes to the three circulars, we posted them on the OMB Web site (*http://www.omb.gov*) as a chart so that readers could easily compare the changes to the selected items of cost among the three circulars. We will again post a chart that displays the final revisions to the cost items across the three circulars so readers could easily compare the final outcomes to the circulars. In this **Federal Register** notice, we set out the specific changes to the selected items of cost of the three circulars separately. In addition, we will post on the OMB Web site the revised versions of the three circulars so that each community can see the final revisions incorporated into each cost principle circular.

Items for Future Consideration

In addition to comments on the proposed items, we received various comments for improvement to the circulars that were not included in our original proposal. We appreciated these comments. However, these recommendations are beyond the scope of the current project. We will consider them at a later phase of the cost consistency streamlining project.

Responses to Comments

We received 184 comments on the proposal: 147 from universities, 13 from State and local governments, 8 from Federal agencies, 4 from not-for-profit organizations and 12 other individuals and entities.

We have reviewed and given consideration to each comment in light of the overall objectives and goals of the project. Many comments resulted in changes in the proposed language while other comments resulted in the withdrawal of certain proposals. We believe that the final revisions accomplished our stated objectives to simplify the cost principles, making the description of similar items consistent and reducing the possibility of misunderstanding.

In summary, we made revisions to our proposed language for 24 cost items and withdrew proposed language for 6 cost items. Forty-five of the proposed changes are made final as proposed. The following chart summarizes the final actions to the proposed items. The detailed discussion of the comments and how those comments were resolved are presented on the OMB Web site along with the revised circulars and the final comparison chart. *See http://www.omb.gov.*

Dated: April 29, 2004.

Joshua B. Bolten,

Director.

Cost items in 3 circulars	Proposal	Adopted as proposed	Adopted as amended	Proposal withdrawn
1. Advertising and public relations	Consistent language across all 3 circulars		X	
2. Alcoholic beverages	No proposed change			X
3. Bad debts	Consistent language across all 3 circulars		X	

Cost items in 3 circulars	Proposal	Adopted as proposed	Adopted as amended	Proposal withdrawn
4. Communication costs	Consistent language across all 3 circulars		X	
5. Compensation for personal services	Various relocation of cost items into this section	X		
6. Contingency provisions	Consistent language across all 3 circulars		X	
7. Donations and contributions	Consistent language across all 3 circulars		X	
8. Defense and prosecution of criminal and civil proceedings, claims, appeals and patent infringement.	No proposed change	X		
9. Depreciation and use allowances	Consistent language across all 3 circulars		X	
10. Employee morale, health, and welfare costs	Consistent language across all 3 circulars	X		
11. Entertainment costs	Consistent language across all 3 circulars	X		
12. Equipment and other capital expenditures	Consistent language across all 3 circulars		X	
13. Fines and penalties	Consistent language across all 3 circulars	X		
14. (Interest), Fund raising and investment management costs.	Consistent language across all 3 circulars			X
15. Insurance and indemnification	No proposed change	X		
16. Interest	Consistent language across all 3 circulars		X	
17. Gain and losses on depreciable assets	No proposed change	X		
18. Profits and losses on disposition of plant, equipment or other capital assets.	Rename to "Gain and losses on depreciable assets" in all 3 circulars.	X		
19. Lobbying	No proposed change	X		
20. Losses on other sponsored agreements or contracts.	No proposed change	X		
21. Maintenance and repair costs	Consistent language across all 3 circulars		X	
22. Material costs	Consistent language across all 3 circulars		X	
23. Memberships, subscriptions and professional activity costs.	Consistent language across all 3 circulars	X		
24. Pre-agreement costs	Consistent language across all 3 circulars			X
25. Professional service costs	Consistent language across all 3 circulars	X		
26. Rearrangement and alteration costs	Revised language to A–21	X		
27. Reconversion costs	Consistent language across all 3 circulars	X		
28. Rental costs of buildings and equipment	Consistent language across all 3 circulars		X	
29. Taxes	No proposed change	X		
30. Travel costs	Consistent language across all 3 circulars		X	

Cost items in only two circulars	Proposal	Adopted as proposed	Adopted as amended	Proposal withdrawn
1. Bonding costs	Consistent language across all 3 circulars	X		
2. Goods or services for personal use	Consistent language across all 3 circulars		X	
3. Housing and personal living expenses	No proposed change	X		
4. Idle facilities and idle capacity	Consistent language across all 3 circulars		X	
5. Labor relations costs	No proposed change	X		
6. Patent costs	Consistent language across all 3 circulars		X	
7. Plant security costs	Consistent language across all 3 circulars		X	
8. Proposal costs	No proposed change	X		
9. Publication and printing costs	Consistent language across all 3 circulars		X	
10. Recruiting costs	Consistent language across all 3 circulars			X
11. Royalties and other costs for use of patents	Consistent language across all 3 circulars	X		
12. Selling and marketing	Consistent language across all 3 circulars	X		
13. Severance pay	Relocate to the "Compensation for personal services" part of A–21 and A–122.	X		
14. Specialized service facilities	Consistent language to A–21 and A–122		X	
15. Termination costs applicable to sponsored agreements.	Consistent language across all 3 circulars		X	
16. Training	Consistent language across all 3 circulars		X	
17. Transportation costs	No proposed change	X		
18. Trustees	No proposed change	X		

Cost items in only one circular	Proposal	Adopted as proposed	Adopted as amended	Proposal withdrawn
1. Accounting	Deleted	X		
2. Advisory Councils	Consistent language across all 3 circulars	X		
3. Alumni/ae activities	No proposed change	X		
4. Audit costs and related services	Consistent language across all 3 circulars		X	
5. Automatic electronic data processing	Deleted	X		
6. Bid and Proposal costs	Deleted	X		
7. Budgeting	Deleted	X		
8. Civil defense costs	Deleted		X	

Cost items in only one circular	Proposal	Adopted as proposed	Adopted as amended	Proposal withdrawn
9. Commencement and convocation costs	No proposed change	X		
10. Deans of faculty and graduate schools	No proposed change	X		
11. Disbursing service	Deleted	X		
12. Executive lobbying costs	Consistent language across all 3 circulars under "lobbying".	X		
13. Fringe benefits	Deleted	X		
14. General government expenses	Revised language for A–87	X		
15. Independent research and development	Deleted	X		
16. Meeting and Conferences	Consistent language across all 3 circulars		X	
17. Motor pools	Deleted	X		
18. Organization costs	No proposed change	X		
19. Overtime, extra-pay shift, and multi shift premiums.	Consistent language across all 3 circulars			X
20. Page charges in professional journals	Consistent language across all 3 circulars		X	
21. Participant support costs	Consistent language across all 3 circulars			X
22. Pension plans	Deleted	X		
23. Relocation costs	Consistent language across all 3 circulars			X
24. Sabbatical leave costs	Relocate under "Compensation for personal services" of A–21.	X		
25. Scholarships and student aid costs	Proposed revision for A–21	X		
26. Student activity costs	No proposed change	X		
27. Under recovery of costs under Federal agreements.	Deleted	X		

Final Revisions

We amend Circulars A–21, A–87 and A–122 under the following three headings:

A. Amendments to Circular A–21.

B. Amendments to Circular A–87.

C. Amendments to Circular A–122.

A. Amendments to Circular A–21

1. Revise the table of contents for section J. to read as follows:

J. General provisions for selected items of cost
- 1. Advertising and public relations costs
- 2. Advisory councils
- 3. Alcoholic beverages
- 4. Alumni/ae activities
- 5. Audit costs and related services
- 6. Bad debts
- 7. Bonding costs
- 8. Commencement and convocation costs
- 9. Communication costs
- 10. Compensation for personal services
- 11. Contingency provisions
- 12. Deans of faculty and graduate schools
- 13. Defense and prosecution of criminal and civil proceedings, claims, appeals and patent infringement
- 14. Depreciation and use allowances
- 15. Donations and contributions
- 16. Employee morale, health, and welfare costs
- 17. Entertainment costs
- 18. Equipment and other capital expenditures
- 19. Fines and penalties
- 20. Fundraising
- 21. Gains and losses on depreciable assets
- 22. Goods or services for personal use
- 23. Housing and personal living expenses
- 24. Idle facilities and idle capital
- 25. Insurance and indemnification
- 26. Interest
- 27. Labor relations costs
- 28. Lobbying
- 29. Losses on other sponsored agreements or contracts
- 30. Maintenance and repair costs
- 31. Material and supplies costs
- 32. Meetings and conferences
- 33. Memberships, subscriptions and professional activity costs
- 34. Patent costs
- 35. Plant and Homeland security costs
- 36. Pre-agreement costs
- 37. Professional service costs
- 38. Proposal costs
- 39. Publication and printing costs
- 40. Rearrangement and alteration costs
- 41. Reconversion costs
- 42. Recruiting costs
- 43. Rental costs of buildings and equipment
- 44. Royalties and other costs for use of patents
- 45. Scholarships and student aid costs
- 46. Selling and marketing
- 47. Specialized service facilities
- 48. Student activity costs
- 49. Taxes
- 50. Termination costs applicable to sponsored agreements
- 51. Training costs
- 52. Transportation costs
- 53. Travel costs
- 54. Trustees

2. Redesignate the sections in paragraph J. as follows:

a. Section J.2. is redesignated as section J.3.

b. Section J.3. is redesignated as section J.4.

c. Section J.6. is redesignated as section J.8.

d. Section J.8. is redesignated as section J.10.

e. Section J.40. is redesignated as section J.10.h.

f. Section J.10. is redesignated as section J.12.

g. Section J.11. is redesignated as section J.13.

h. Section J.19. is redesignated as section J.22.

i. Section J.20. is redesignated as section J.23.

j. Section J.21. is redesignated as section J.25.

k. Section J.13. is redesignated as section J.27.

l. Section J.24. is redesignated as section J.28.

m. Section J.25. is redesignated as section J.29.

n. Section J.31. is redesignated as section J.36.

o. Section J.34. is redesignated as section J.38.

p. Section J.37. is redesignated as section J.42.

q. Section J.45. is redesignated as section J.48.

r. Section J.46. is redesignated as section J.49.

s. Section J.47. is redesignated as section J.52.

t. Section J.50. is redesignated as section J.54.

3. Section J.1. is revised to read as follows:

1. *Advertising and public relations costs.*

a. The term advertising costs means the costs of advertising media and corollary administrative costs. Advertising media include magazines, newspapers, radio and television, direct mail, exhibits, electronic or computer transmittals, and the like.

b. The term public relations includes community relations and means those activities dedicated to maintaining the image of the institution or maintaining

or promoting understanding and favorable relations with the community or public at large or any segment of the public.

c. The only allowable advertising costs are those that are solely for:

(1) The recruitment of personnel required for the performance by the institution of obligations arising under a sponsored agreement (See also subsection b. of section J.42, Recruiting.);

(2) The procurement of goods and services for the performance of a sponsored agreement;

(3) The disposal of scrap or surplus materials acquired in the performance of a sponsored agreement except when institutions are reimbursed for disposal costs at a predetermined amount; or

(4) Other specific purposes necessary to meet the requirements of the sponsored agreement.

d. The only allowable public relations costs are:

(1) Costs specifically required by the sponsored agreement;

(2) Costs of communicating with the public and press pertaining to specific activities or accomplishments which result from performance of sponsored agreements (these costs are considered necessary as part of the outreach effort for the sponsored agreement); or

(3) Costs of conducting general liaison with news media and government public relations officers, to the extent that such activities are limited to communication and liaison necessary keep the public informed on matters of public concern, such as notices of Federal contract/grant awards, financial matters, *etc.*

e. Costs identified in subsections c and d if incurred for more than one sponsored agreement or for both sponsored work and other work of the institution, are allowable to the extent that the principles in sections D. ("Direct Costs") and E. ("F & A Costs") are observed.

f. Unallowable advertising and public relations costs include the following:

(1) All advertising and public relations costs other than as specified in subsections 1.c, 1.d, and 1.e;

(2) Costs of meetings, conventions, convocations, or other events related to other activities of the institution, including:

(a) Costs of displays, demonstrations, and exhibits;

(b) Costs of meeting rooms, hospitality suites, and other special facilities used in conjunction with shows and other special events; and

(c) Salaries and wages of employees engaged in setting up and displaying exhibits, making demonstrations, and providing briefings;

(3) Costs of promotional items and memorabilia, including models, gifts, and souvenirs;

(4) Costs of advertising and public relations designed solely to promote the institution.

4. Section J.2. is revised to read as follows:

2. Advisory councils.

Costs incurred by advisory councils or committees are allowable as a direct cost where authorized by the Federal awarding agency or as an indirect cost where allocable to sponsored agreements.

5. Section J.5. is revised to read as follows:

5. *Audit costs and related services.*

a. The costs of audits required by, and performed in accordance with, the Single Audit Act, as implemented by Circular A–133, "Audits of States, Local Governments, and Non-Profit Organizations" are allowable. *Also see* 31 U.S.C. 7505(b) and section __.230 ("Audit Costs") of Circular A–133.

b. Other audit costs are allowable if included in an indirect cost rate proposal, or if specifically approved by the awarding agency as a direct cost to an award.

c. The cost of agreed-upon procedures engagements to monitor subrecipients who are exempted from A–133 under section __.200(d) are allowable, subject to the conditions listed in A–133, section __.230(b)(2).

6. Section J.6. is revised to read as follows:

6. *Bad Debts.*

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

7. Section J.7. is revised to read as follows:

7. *Bonding costs.*

a. Bonding costs arise when the Federal Government requires assurance against financial loss to itself or others by reason of the act or default of the institution. They arise also in instances where the institution 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 institution 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.

8. Section J.9. is revised to read as follows:

9. *Communication costs.*

Costs incurred for telephone services, local and long distance telephone calls, telegrams, postage, messenger, electronic or computer transmittal services and the like are allowable.

9. Amend redesignated section J.10. by redesignating former section J.10.f.(4) as section J.10.f.(5), adding a new section J.10.f.(4), and adding a new section J.10.h. to read as follows:

10. *Compensation for personal services.*

* * * * *

f. Fringe benefits.

* * * * *

(4) Rules for sabbatical leave are as follows:

(a) Costs of leave of absence by employees for performance of graduate work or sabbatical study, travel, or research are allowable provided the institution has a uniform policy on sabbatical leave for persons engaged in instruction and persons engaged in research. Such costs will be allocated on an equitable basis among all related activities of the institution.

(b) Where sabbatical leave is included in fringe benefits for which a cost is determined for assessment as a direct charge, the aggregate amount of such assessments applicable to all work of the institution during the base period must be reasonable in relation to the institution's actual experience under its sabbatical leave policy.

* * * * *

h. Severance pay.

(1) Severance pay is compensation in addition to regular salary and wages which are paid by an institution to employees whose services are being terminated. Costs of severance pay are allowable only to the extent that such payments are required by law, by employer-employee agreement, by established policy that constitutes in effect an implied agreement on the institution's part, or by circumstances of the particular employment.

(2) Severance payments that are due to normal recurring turnover and which otherwise meet the conditions of subsection a may be allowed provided the actual costs of such severance payments are regarded as expenses applicable to the current fiscal year and are equitably distributed among the institution's activities during that period.

(3) Severance payments that are due to abnormal or mass terminations are of such conjectural nature that allowability must be determined on a case-by-case basis. However, the Federal Government recognizes its obligation to participate, to the extent of its fair share, in any specific payment.

(4) Costs incurred in excess of the institution's normal severance pay policy applicable to all persons employed by the institution upon termination of employment are unallowable.

20. Section J.11. is revised to read as follows:

11. *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, except as noted in the cost principles in this circular regarding self insurance, pensions, severance and post-retirement health costs.

11. Sections J.14. through 18. are revised to read as follows:

14. *Depreciation and use allowances.*

a. Institutions may be compensated for the use of their buildings, capital improvements, and equipment, provided that they are used, needed in the institutions' activities, and properly allocable to sponsored agreements. Such compensation shall be made by computing either depreciation or use allowance. Use allowances are the means of providing such compensation when depreciation or other equivalent costs are not computed. The allocation for depreciation or use allowance shall be made in accordance with Section F.2. Depreciation and use allowances are computed applying the following rules:

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

c. For this purpose, the acquisition cost 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 is presently located; and

(3) any portion of the cost of buildings and equipment contributed by or for the institution where law or agreement prohibits recovery.

d. In the use of the depreciation method, the following shall be observed:

(1) 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, technological developments in the particular area, and the renewal and replacement policies followed for the individual items or classes of assets involved.

(2) The depreciation method used to charge the cost of an asset (or group of assets) to accounting periods shall reflect the pattern of consumption of the asset during its useful life. In the absence of clear evidence indicating that the expected consumption of the asset will be significantly greater in the early portions than in the later portions of its useful life, 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. The depreciation methods used to calculate the depreciation amounts for F&A rate purposes shall be the same methods used by the institution for its financial statements. This requirement does not apply to those institutions (*e.g.*, public institutions of higher education) which are not required to record depreciation by applicable generally accepted accounting principles (GAAP).

(3) Where the depreciation method is introduced to replace the use allowance method, depreciation shall be computed as if the asset had been depreciated over its entire life (*i.e.*, from the date the asset was acquired and ready for use to the date of disposal or withdrawal from service). The aggregate amount of use allowances and depreciation attributable to an asset (including imputed depreciation applicable to periods prior to the conversion to the use allowance method as well as depreciation after the conversion) may be less than, and in no case, greater than the total acquisition cost of the asset.

(4) The entire building, including the shell and all components, may be treated as a single asset and depreciated over a single useful life. A building may also be divided into multiple components. Each component item may then be depreciated over its estimated useful life. The building components shall be grouped into three general components of a building: building shell (including construction and design costs), building services systems (*e.g.*, elevators, HVAC, plumbing system and heating and air-conditioning system) and fixed equipment (*e.g.*, sterilizers, casework, fume hoods, cold rooms and glassware/washers). In exceptional cases, a Federal cognizant agency may authorize an institution to use more than these three groupings. When an institutiton elects to depreciate its buildings by its components, the same depreciation methods must be used for F&A purposes and financial statement purposes, as described in subsection d.(2).

(5) Where the depreciation method is used for a particular class of assets, no depreciation may be allowed on any such assets that have outlived their depreciable lives. (*See also* subsection e.(3))

e. Under the use allowance method, the following shall be observed:

(1) The use allowance for buildings and improvements (including improvements such as paved parking areas, fences, and sidewalks) shall be computed at an annual rate not exceeding two percent of acquisition cost.

The use allowance for equipment shall be computed at an annual rate not exceeding six and two-thirds percent of acquisition cost. Use allowance recovery is limited to the acquisition cost of the assets. For donated assets, use allowance recovery is limited to the fair market value of the assets at the time of donation.

(2) In contrast to the depreciation method, the entire building must be treated as a single asset without separating its "shell" from other building components under the use allowance method. The entire building must be treated as a single asset, and the two-percent use allowance limitation must be applied to all parts of the building.

The two-percent limitation, however, need not be applied to equipment or other assets that are merely attached or fastened to the building but not permanently fixed and are used as furnishings, decorations or for specialized purposes (*e.g.*, dentist chairs and dental treatment units, counters, laboratory benches bolted to the floor, dishwashers, modular furniture, and carpeting). Such equipment and assets will be considered as not being permanently fixed to the building if they can be removed without the need for costly or extensive alterations or repairs to the building to make the space usable for other purposes. Equipment and assets that meet these criteria will be subject to the 6⅔ percent equipment use allowance.

(3) A reasonable use allowance may be negotiated for any assets that are considered to be fully depreciated, after taking into consideration the amount of depreciation previously charged to the Federal Government, the estimated useful life remaining at the time of negotiation, the effect of any increased maintenance charges, decreased efficiency due to age, and any other factors pertinent to the utilization of the asset for the purpose contemplated.

(4) Notwithstanding subsection e.(3), once an institution converts from one cost recovery methodology to another, acquisition costs not recovered may not

be used in the calculation of the use allowance in subsection e.(3).

f. Except as otherwise provided in subsections b. through e., a combination of the depreciation and use allowance methods may not be used, in like circumstances, for a single class of assets (*e.g.*, buildings, office equipment, and computer equipment).

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 to ensure that the assets exist and are usable, used, and needed. Statistical sampling techniques may be used in taking these inventories. In addition, when the depreciation method is used, adequate depreciation records showing the amount of depreciation taken each period must also be maintained.

h. This section applies to the largest college and university recipients of Federal research and development funds as displayed in Exhibit A, List of Colleges and Universities Subject to Section J.14.f of Circular A–21.

(1) Institutions shall expend currently, or reserve for expenditure within the next five years, the portion of F&A cost payments made for depreciation or use allowances under sponsored research agreements, consistent with Section F.2, to acquire or improve research facilities. This provision applies only to Federal agreements, which reimburse F&A costs at a full negotiated rate. These funds may only be used for (a) liquidation of the principal of debts incurred to acquire assets that are used directly for organized research activities, or (b) payments to acquire, repair, renovate, or improve buildings or equipment directly used for organized research. For buildings or equipment not exclusively used for organized research activity, only appropriately proportionate amounts will be considered to have been expended for research facilities.

(2) An assurance that an amount equal to the Federal reimbursements has been appropriately expended or reserved to acquire or improve research facilities shall be submitted as part of each F&A cost proposal submitted to the cognizant Federal agency which is based on costs incurred on or after October 1, 1991. This assurance will cover the cumulative amounts of funds received and expended during the period beginning after the period covered by the previous assurance and ending with the fiscal year on which the proposal is based. The assurance shall also cover any amounts reserved from a prior period in which the funds received exceeded the amounts expended.

15. *Donations and contributions.*

a. Contributions or donations rendered.

Contributions or donations, including cash, property, and services, made by the institution, regardless of the recipient, are unallowable.

b. Donated services received.

Donated or volunteer services may be furnished to an institution 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 F&A cost. However, the value of donated services may be used to meet cost sharing or matching requirements in accordance with Circular A–110.

c. Donated property.

The value of donated property is not reimbursable either as a direct or F&A cost, except that depreciation or use allowances on donated assets are permitted in accordance with Section J.14. The value of donated property may be used to meet cost sharing or matching requirements, in accordance with Circular A–110.

16. *Employee morale, health, and welfare costs.*

a. The costs of employee information publications, health or first-aid clinics and/or infirmaries, recreational activities, employee counseling services, and any other expenses incurred in accordance with the institution's established practice or custom for the improvement of working conditions, employer-employee relations, employee morale, and employee performance are allowable.

b. Such costs will be equitably apportioned to all activities of the institution. 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.

c. Losses resulting from operating food services are allowable only if the institution's objective is to operate such services on a break-even basis. Losses sustained because of operating objectives other than the above are allowable only (a) where the institution can demonstrate unusual circumstances, and (b) with the approval of the cognizant Federal agency.

17. *Entertainment costs.*

Costs of entertainment, including amusement, diversion, and social activities and any costs directly associated with such costs (such as tickets to shows or sports events, meals, lodging, rentals, transportation, and gratuities) are unallowable.

18. *Equipment and other capital expenditures.*

a. For purposes of this subsection, the following definitions apply:

(1) "Capital Expenditures" means expenditures for the acquisition cost of capital assets (equipment, buildings, and land), or expenditures to make improvements to capital assets that materially increase their value or useful life. Acquisition cost means the cost of the asset including the cost to put it in place. Acquisition cost for equipment, for example, means the net invoice price of the 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 may be included in, or excluded from the acquisition cost in accordance with the institution's regular accounting practices.

(2) "Equipment" means an article of nonexpendable, tangible personal property having a useful life of more than one year and an acquisition cost which equals or exceeds the lesser of the capitalization level established by the institution for financial statement purposes, or $5000.

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

(4) "General purpose equipment" means equipment, which is not limited to research, medical, scientific or other technical activities. Examples include office equipment and furnishings, modular offices, telephone networks, information technology equipment and systems, air conditioning equipment, reproduction and printing equipment, and motor vehicles.

b. The following rules of allowability shall apply to equipment and other capital expenditures:

(1) Capital expenditures for general purpose equipment, buildings, and land are unallowable as direct charges, except where approved in advance by the awarding agency.

(2) Capital expenditures for special purpose equipment are allowable as direct costs, provided that items with a unit cost of $5000 or more have the prior approval of the awarding agency.

(3) 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.

(4) When approved as a direct charge pursuant to subsections J.18.b.(1)

through (3), capital expenditures will be charged in the period in which the expenditure is incurred, or as otherwise determined appropriate by and negotiated with the awarding agency.

(5) Equipment and other capital expenditures are unallowable as indirect costs. However, see section J.14, Depreciation and use allowance, for rules on the allowability of use allowances or depreciation on buildings, capital improvements, and equipment. Also, see section J.43, Rental costs of buildings and equipment, for rules on the allowability of rental costs for land, buildings, and equipment.

(6) The unamortized portion of any equipment written off as a result of a change in capitalization levels may be recovered by continuing to claim the otherwise allowable use allowances or depreciation on the equipment, or by amortizing the amount to be written off over a period of years negotiated with the cognizant agency.

12. Sections J.20. and 21. are revised to read as follows:

20. *Fund raising and investment costs.*

a. 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.

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

c. Costs related to the physical custody and control of monies and securities are allowable.

21. *Gain and losses on depreciable assets.*

a. (1) Gains and losses on the sale, retirement, or other disposition of depreciable property shall be included in the year in which they occur as credits or charges to the asset cost grouping(s) in which the property was included. The amount of the gain or loss to be included as a credit or charge to the appropriate asset 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 account and is reflected in the depreciation allowable under section J.14.

(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 Section J.24.

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

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

c. When assets acquired with Federal funds, in part or wholly, are disposed of, the distribution of the proceeds shall be made in accordance with Circular A–110, "Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations."

13. Section J.24. is revised to read as follows:

24. *Idle facilities and idle capacity.*

a. As used in this section 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 institution.

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

(3) "Idle capacity" means the unused capacity of partially used facilities. It is the difference between:

(a) That which a facility could achieve under 100 percent operating time on a one-shift basis less operating interruptions resulting from time lost for repairs, setups, unsatisfactory materials, and other normal delays; and

(b) The extent to which the facility was actually used to meet demands during the accounting period. A multi-shift basis should be used if it can be shown that this amount of usage would normally be expected for the type of facility involved.

(4) "Cost of idle facilities or idle capacity" means costs such as maintenance, repair, housing, rent, and other related costs, *e.g.*, insurance, interest, property taxes 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 subsection, costs of idle facilities are allowable for a reasonable period of time, ordinarily not to exceed one year, depending on the initiative taken to use, lease, or dispose of such facilities.

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 that the capacity is reasonably anticipated to be necessary or was originally reasonable and is not subject to reduction or elimination by use on other sponsored agreements, subletting, renting, or sale, in accordance with sound business, economic, or security practices. Widespread idle capacity throughout an entire facility or among a group of assets having substantially the same function may be considered idle facilities.

14. Section J.26. is revised to read as follows:

26. Interest.

a. Costs incurred for interest on borrowed capital, temporary use of endowment funds, or the use of the institution's own funds, however represented, are unallowable. However, interest on debt incurred after July 1, 1982 to acquire buildings, major reconstruction and remodeling, or the acquisition or fabrication of capital equipment costing $10,000 or more, is allowable.

b. Interest on debt incurred after May 8, 1996 to acquire or replace capital assets (including construction, renovations, alterations, equipment, land, and capital assets acquired through capital leases) acquired after that date and used in support of sponsored agreements is allowable, subject to the following conditions:

(1) For facilities costing over $500,000, the institution shall prepare, prior to acquisition or replacement of the facility, a lease-purchase analysis in accordance with the provisions of Sec.__.30 through__.37 of OMB Circular A–110, which shows that a financed purchase, including a capital lease is less costly to the institution than other operating lease alternatives, on a net present value basis. Discount rates used shall be equal to the institution's anticipated interest rates and shall be no higher than the fair market rate available to the institution from an unrelated ("arm's length") third-party. The lease-purchase analysis shall include a comparison of the net present value of the projected total cost comparisons of both alternatives over the period the asset is expected to be used by the institution. The cost comparisons

associated with purchasing the facility shall include the estimated purchase price, anticipated operating and maintenance costs (including property taxes, if applicable) not included in the debt financing, less any estimated asset salvage value at the end of the defined period. The cost comparison for a capital lease shall include the estimated total lease payments, any estimated bargain purchase option, operating and maintenance costs, and taxes not included in the capital leasing arrangement, less any estimated credits due under the lease at the end of the defined period. Projected operating lease costs shall be based on the anticipated cost of leasing comparable facilities at fair market rates under rental agreements that would be renewed or reestablished over the period defined above, and any expected maintenance costs and allowable property taxes to be borne by the institution directly or as part of the lease arrangement.

(2) The actual interest cost claimed is predicated upon interest rates that are no higher than the fair market rate available to the institution from an unrelated (arm's length) third party.

(3) Investment earnings, including interest income on bond or loan principal, pending payment of the construction or acquisition costs, are used to offset allowable interest cost. Arbitrage earnings reportable to the Internal Revenue Service are not required to be offset against allowable interest costs.

(4) Reimbursements are limited to the least costly alternative based on the total cost analysis required under subsection (1). For example, if an operating lease is determined to be less costly than purchasing through debt financing, then reimbursement is limited to the amount determined if leasing had been used. In all cases where a lease-purchase analysis is required to be performed, Federal reimbursement shall be based upon the least expensive alternative.

(5) For debt arrangements over $1 million, unless the institution makes an initial equity contribution to the asset purchase of 25 percent or more, the institution shall reduce claims for interest expense by an amount equal to imputed interest earnings on excess cash flow, which is to be calculated as follows. Annually, institutions shall prepare a cumulative (from the inception of the project) report of monthly cash flows that includes inflows and outflows, regardless of the funding source. Inflows consist of depreciation expense, amortization of capitalized construction interest, and annual interest cost. For cash flow calculations, the annual inflow figures shall be divided by the number of months in the year (*i.e.*, usually 12) that the building is in service for monthly amounts. Outflows consist of initial equity contributions, debt principal payments (less the pro rata share attributable to the unallowable costs of land) and interest payments. Where cumulative inflows exceed cumulative outflows, interest shall be calculated on the excess inflows for that period and be treated as a reduction to allowable interest cost. The rate of interest to be used to compute earnings on excess cash flows shall be the three-month Treasury bill closing rate as of the last business day of that month.

(6) Substantial relocation of federally-sponsored activities from a facility financed by indebtedness, the cost of which was funded in whole or part through Federal reimbursements, to another facility prior to the expiration of a period of 20 years requires notice to the cognizant agency. The extent of the relocation, the amount of the Federal participation in the financing, and the depreciation and interest charged to date may require negotiation and/or downward adjustments of replacement space charged to Federal programs in the future.

(7) The allowable costs to acquire facilities and equipment are limited to a fair market value available to the institution from an unrelated (arm's length) third party.

c. Institutions are also subject to the following conditions:

(1) Interest on debt incurred to finance or refinance assets re-acquired after the applicable effective dates stipulated above is unallowable.

(2) Interest attributable to fully depreciated assets is unallowable.

d. The following definitions are to be used for purposes of this section:

(1) "Re-acquired" assets means assets held by the institution prior to the applicable effective dates stipulated above that have again come to be held by the institution, whether through repurchase or refinancing. It does not include assets acquired to replace older assets.

(2) "Initial equity contribution" means the amount or value of contributions made by institutions for the acquisition of the asset prior to occupancy of facilities.

(3) "Asset costs" means the capitalizable costs of an asset, including construction costs, acquisition costs, and other such costs capitalized in accordance with Generally Accepted Accounting Principles (GAAP).

15. Add a new subsection h. to the redesignated section J.28., to read as follows.

28. *Lobbying.*

* * * * *

h. Executive lobbying costs.

Costs incurred in attempting to improperly influence either directly or indirectly, an employee or officer of the Executive Branch of the Federal Government to give consideration or to act regarding a sponsored agreement or a regulatory matter are unallowable. Improper influence means any influence that induces or tends to induce a Federal employee or officer to give consideration or to act regarding a federally-sponsored agreement or regulatory matter on any basis other than the merits of the matter.

16. Sections J.30. through 35. are revised to read as follows:

30. *Maintenance and repair costs.*

Costs incurred for necessary maintenance, repair, or upkeep of buildings and equipment (including Federal 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* section 18.a.(1)).

31. *Material and supplies costs.*

a. Costs incurred for materials, supplies, and fabricated parts necessary to carry out a sponsored agreement are allowable.

b. Purchased materials and supplies shall be charged at their actual prices, net of applicable credits. Withdrawals from general stores or stockrooms should be charged at their actual net cost under any recognized method of pricing inventory withdrawals, consistently applied. Incoming transportation charges are a proper part of materials and supplies costs.

c. Only materials and supplies actually used for the performance of a sponsored agreement may be charged as direct costs.

d. Where federally-donated or furnished materials are used in performing the sponsored agreement, such materials will be used without charge.

32. *Meetings and conferences.*

Costs of meetings and conferences, the primary purpose of which is the dissemination of technical information, are allowable. This includes costs of meals, transportation, rental of facilities, speakers' fees, and other items

incidental to such meetings or conferences. But *see* section J.17, Entertainment costs.

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

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

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

c. Costs of membership in any civic or community organization are unallowable.

d. Costs of membership in any country club or social or dining club or organization are unallowable.

34. Patent costs.

a. The following costs relating to patent and copyright matters are allowable:

(1) Cost of preparing disclosures, reports, and other documents required by the sponsored agreement and of searching the art to the extent necessary to make such disclosures;

(2) Cost of 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 Federal Government to be conveyed to the Federal Government; and

(3) General counseling services relating to patent and copyright matters, such as advice on patent and copyright laws, regulations, clauses, and employee agreements (but see sections J.37., Professional services costs, and J.44., Royalties and other costs for use of patents).

b. The following costs related to patent and copyright matter are unallowable:

(i) Cost of preparing disclosures, reports, and other documents and of searching the art to the extent necessary to make disclosures not required by the award

(ii) Costs in connection with filing and prosecuting any foreign patent application, or any United States patent application, where the sponsored agreement does not require conveying title or a royalty-free license to the Federal Government, (but *see* section J.44, Royalties and other costs for use of patents).

35. *Plant and homeland security costs.*

Necessary and reasonable expenses incurred for routine and homeland security to protect facilities, personnel, and work products are allowable. Such costs include, but are not limited to, wages and uniforms of personnel engaged in security activities; equipment; barriers; contractual security services; consultants; *etc.* Capital expenditures for homeland and plant security purposes are subject to section J.18, Equipment and other capital expenditures, of this Circular.

17. Revise section J.37. to read as follows:

37. *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 institution, are allowable, subject to subsections b and c when reasonable in relation to the services rendered and when not contingent upon recovery of the costs from the Federal Government. In addition, legal and related services are limited under section J.13.

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

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

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

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

(4) The impact of sponsored agreements on the institution's business (*i.e.*, what new problems have arisen).

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

(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 subsection b, retainer fees to be allowable must be supported by evidence of bona fide services available or rendered.

18. Sections J.39., J.40. and J.41. are revised to read as follows:

39. *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. Publication costs also include page charges in professional publications.

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 institution.

c. Page charges for professional journal publications are allowable as a necessary part of research costs where:

(1) The research papers report work supported by the Federal Government: and

(2) The charges are levied impartially on all research papers published by the journal, whether or not by federally-sponsored authors.

40. *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 sponsoring agency.

41. *Reconversion costs.*

Costs incurred in the restoration or rehabilitation of the institution's facilities to approximately the same condition existing immediately prior to commencement of a sponsored agreement, fair wear and tear excepted, are allowable.

19. Revise sections J.43. through J.47. to read as follows:

43. *Rental costs of buildings and equipment.*

a. Subject to the limitations described in subsections b. through d. of this section, 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. Rental arrangements should be reviewed periodically to determine if circumstances have changed and other options are available.

b. Rental costs under "sale and lease back" arrangements are allowable only up to the amount that would be allowed had the institution continued to own the property. This amount would include expenses such as depreciation or use allowance, maintenance, taxes, and insurance.

c. Rental costs under "less-than-arms-length" leases are allowable only up to the amount (as explained in subsection b) that would be allowed had title to the property vested in the institution. 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—

(1) divisions of an institution;

(2) institutions under common control through common officers, directors, or members; and

(3) an institution and a director, trustee, officer, or key employee of the institution or his immediate family, either directly or through corporations, trusts, or similar arrangements in which they hold a controlling interest. For example, an institution may establish a separate corporation for the sole purpose of owning property and leasing it back to the institution.

d. Rental costs under leases which are required to be treated as capital leases under GAAP are allowable only up to the amount (as explained in subsection b) that would be allowed had the institution purchased the property on the date the lease agreement was executed. The provisions of Financial Accounting Standards Board Statement 13, Accounting for Leases, shall be used to determine whether a lease is a capital lease. Interest costs related to capital leases are allowable to the extent they meet the criteria in section J.25. Unallowable costs include amounts paid for profit, management fees, and taxes that would not have been incurred had the institution purchased the facility.

44. *Royalties and other costs for use of patents.*

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 Federal 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-than-arm's-length bargaining, *e.g.:*

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

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

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

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

45. *Scholarships and student aid costs.*

a. Costs of scholarships, fellowships, and other programs of student aid are allowable only when the purpose of the sponsored agreement is to provide training to selected participants and the charge is approved by the sponsoring agency. However, tuition remission and other forms of compensation paid as, or in lieu of, wages to students performing necessary work are allowable provided that—

(1) The individual is conducting activities necessary to the sponsored agreement;

(2) Tuition remission and other support are provided in accordance with established educational institutional policy and consistently provided in a like manner to students in return for similar activities conducted in nonsponsored as well as sponsored activities; and

(3) During the academic period, the student is enrolled in an advanced degree program at a grantee or affiliated institution and the activities of the student in relation to the Federally-sponsored research project are related to the degree program;

(4) the tuition or other payments are reasonable compensation for the work performed and are conditioned explicitly upon the performance of necessary work; and

(5) it is the institution's practice to similarly compensate students in nonsponsored as well as sponsored activities.

b. Charges for tuition remission and other forms of compensation paid to students as, or in lieu of, salaries and wages shall be subject to the reporting requirements stipulated in Section J.10, and shall be treated as direct or F&A cost in accordance with the actual work being performed. Tuition remission may be charged on an average rate basis.

46. *Selling and marketing.*

Costs of selling and marketing any products or services of the institution are unallowable (unless allowed under section J.1 as allowable public relations costs or under section J.38 as allowable proposal costs).

47. *Specialized service facilities.*

a. The costs of services provided by highly complex or specialized facilities operated by the institution, such as computers, wind tunnels, and reactors are allowable, provided the charges for the services meet the conditions of either subsection 47.b. or 47.c. and, in addition, take into account any items of income or Federal financing that qualify as applicable credits under section C.5 of this Circular.

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

(1) does not discriminate against federally-supported activities of the institution, including usage by the institution for internal purposes, and

(2) 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 F&A costs. Rates shall be adjusted at least biennially, and shall take into consideration over/under applied costs of the previous period(s).

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

d. Under some extraordinary circumstances, where it is in the best interest of the Federal Government and the institution to establish alternative costing arrangements, such arrangements may be worked out with the cognizant Federal agency.

20. Section J.50. is revised to read as follows:

50. *Termination costs applicable to sponsored agreements.*

Termination of awards generally gives rise to the incurrence of costs, or the need for special treatment of costs, which would not have arisen had the sponsored agreement 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. The cost of items reasonably usable on the institution's other work shall not be allowable unless the institution 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 institution, the awarding agency should consider the institution's plans and orders for current and scheduled activity.

Contemporaneous purchases of common items by the institution shall be regarded as evidence that such items are reasonably usable on the institution's other work. Any acceptance of common items as allocable to the terminated portion of the sponsored agreement 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. If in a particular case, despite all reasonable efforts by the institution, 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 institution to discontinue such costs shall be unallowable.

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

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

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

(3) The loss of useful value for any one terminated sponsored agreement is limited to that portion of the acquisition cost which bears the same ratio to the total acquisition cost as the terminated portion of the sponsored agreement bears to the entire terminated sponsored agreement and other sponsored agreements for which the special tooling, machinery, or equipment was acquired.

d. Rental costs under unexpired leases are generally allowable where clearly shown to have been reasonably necessary for the performance of the terminated sponsored agreement, less the residual value of such leases, if:

(1) the amount of such rental claimed does not exceed the reasonable use value of the property leased for the period of the sponsored agreement and such further period as may be reasonable; and

(2) the institution 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 sponsored agreement, and of reasonable restoration required by the provisions of the lease.

e. Settlement expenses including the following are generally allowable:

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

(a) The preparation and presentation to the awarding agency of settlement claims and supporting data with respect to the terminated portion of the sponsored agreement, unless the termination is for default (*see* Subpart __.61 of Circular 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 Federal Government or acquired or produced for the sponsored agreement, except when grantees or contractors are reimbursed for disposals at a predetermined amount in accordance with sections __.32 through __.37 of Circular A–110.

(3) F&A costs related to salaries and wages incurred as settlement expenses in subsections b.(1) and (2) of this section 50. Normally, such F&A costs shall be limited to fringe benefits, occupancy cost, and immediate supervision.

f. Claims under subawards, including the allocable portion of claims which are common to the sponsored agreement and to other work of the institution, are generally allowable.

An appropriate share of the institution's F&A costs may be allocated to the amount of settlements with subcontractors and/or subgrantees, provided that the amount allocated is otherwise consistent with the basic guidelines contained in section E, F&A costs. The F&A costs so allocated shall exclude the same and similar costs claimed directly or indirectly as settlement expenses.

21. Add a new section J.51. to read as follows:

51. *Training costs.*

The cost of training provided for employee development is allowable.

22. Add a new section J.53. to read as follows:

53. *Travel costs.*

a. General.

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 institution. Such costs may be charged on an actual cost basis, on a per diem or mileage basis in lieu of actual costs incurred, or on a combination of the two, provided the method used is applied to an entire trip and not to selected days of the trip, and results in charges consistent with those normally allowed in like circumstances in the institution's non-federally-sponsored activities.

b. Lodging and subsistence.

Costs incurred by employees and officers for travel, including costs of lodging, other subsistence, and incidental expenses, shall be considered reasonable and allowable only to the extent such costs do not exceed charges normally allowed by the institution in its regular operations as the result of the institution's written travel policy. In the absence of an acceptable, written institution policy regarding travel costs, the rates and amounts established under subchapter I of Chapter 57, Title 5, United States Code ("Travel and Subsistence Expenses; Mileage Allowances"), or by the Administrator of General Services, or by the President (or his or her designee) pursuant to any provisions of such subchapter shall apply to travel under sponsored agreements (48 CFR 31.205–46(a)).

c. Commercial air travel.

(1) Airfare costs in excess of the customary standard commercial airfare (coach or equivalent), Federal Government contract airfare (where authorized and available), or the lowest commercial discount airfare are unallowable except when such accommodations would:

(a) require circuitous routing;

(b) require travel during unreasonable hours;

(c) excessively prolong travel;

(d) result in additional costs that would offset the transportation savings; or

(e) offer accommodations not reasonably adequate for the traveler's medical needs. The institution must justify and document these conditions on a case-by-case basis in order for the use of first-class airfare to be allowable in such cases.

(2) Unless a pattern of avoidance is detected, the Federal Government will generally not question an institution's determinations that customary standard airfare or other discount airfare is unavailable for specific trips if the institution can demonstrate either of the following:

(a) That such airfare was not available in the specific case; or

(b) That it is the institution's overall practice to make routine use of such airfare.

d. Air travel by other than commercial carrier.

Costs of travel by institution-owned, -leased, or -chartered aircraft include the cost of lease, charter, operation (including personnel costs), maintenance, depreciation, insurance, and other related costs. The portion of such costs that exceeds the cost of allowable commercial air travel, as provided for in subsection J.53.c., is unallowable.

B. Amendments to Circular A–87

1. Revise Attachment A, section C.3.c., of OMB Circular A–87, to read as follows:

C. Basic Guidelines

* * * * *

3. Allocable costs

* * * * *

c. Any cost allocable to a particular Federal award or cost objective under the principles provided for in this Circular may not be charged to other Federal awards to overcome fund deficiencies, to avoid restrictions imposed by law or terms of the Federal awards, or for other reasons.

2. Revise the table of contents to Attachment B as follows:

Attachment B.—Selected Items of Cost

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1. Advertising and public relations costs
2. Advisory councils
3. Alcoholic beverages
4. Audit costs and related services
5. Bad debts
6. Bonding costs
7. Communication costs
8. Compensation for personal services
9. Contingency provisions
10. Defense and prosecution of criminal and civil proceedings, and claims
11. Depreciation and use allowances
12. Donations and contributions
13. Employee morale, health, and welfare costs
14. Entertainment costs
15. Equipment and other capital expenditures
16. Fines and penalties
17. Fund raising and investment management costs
18. Gains and losses on disposition of depreciable property and other capital assets and substantial relocation of Federal programs
19. General government expenses
20. Goods or services for personal use
21. Idle facilities and idle capacity
22. Insurance and indemnification
23. Interest
24. Lobbying
25. Maintenance, operations, and repairs
26. Materials and supplies costs
27. Meetings and conferences
28. Memberships, subscriptions, and professional activity costs
29. Patent costs
30. Plant and homeland security costs
31. Pre-award costs
32. Professional service costs
33. Proposal costs
34. Publication and printing costs
35. Rearrangement and alteration costs
36. Reconversion costs
37. Rental costs of building and equipment
38. Royalties and other costs for the use of patents
39. Selling and marketing
40. Taxes
41. Termination costs applicable to Federal awards
42. Training costs
43. Travel costs

3. Redesignate the sections in Attachment B as follows:

a. Section 3. is redesignated as section 2.

b. Section 4. is redesignated as section 3.

c. Section 11. is redesignated as section 8.

d. Section 14. is redesignated as section 10.

e. Section 20. is redesignated as section 16.

f. Section 21. is redesignated as section 17.

g. Section 22. is redesignated as section 18.

h. Section 25. is redesignated as section 22.

i. Section 27. is redesignated as section 24.

j. Section 28. is redesignated as section 25.

k. Section 32. is redesignated as section 31.

l. Section 34. is redesignated as section 33.

m. Section 36. is redesignated as section 35.

n. Section 39. is redesignated as section 40.

o. Section 40. is redesignated as section 42.

4. Attachment B, section 1. is revised to read as follows:

1. *Advertising and public relations costs.*

a. The term advertising costs means the costs of advertising media and corollary administrative costs.

Advertising media include magazines, newspapers, radio and television, direct mail, exhibits, electronic or computer transmittals, and the like.

b. The term public relations includes community relations and means those activities dedicated to maintaining the image of the governmental unit or maintaining or promoting understanding and favorable relations with the community or public at large or any segment of the public.

c. The only allowable advertising costs are those which are solely for:

(1) The recruitment of personnel required for the performance by the governmental unit of obligations arising under a Federal award;

(2) The procurement of goods and services for the performance of a Federal award;

(3) The disposal of scrap or surplus materials acquired in the performance of a Federal award except when institutions are reimbursed for disposal costs at a predetermined amount; or

(4) Other specific purposes necessary to meet the requirements of the Federal award.

d. The only allowable public relations costs are:

(1) Costs specifically required by the Federal award;

(2) Costs of communicating with the public and press pertaining to specific activities or accomplishments which result from performance of Federal awards (these costs are considered necessary as part of the outreach effort for the Federal award); or

(3) Costs of conducting general liaison with news media and government public relations officers, to the extent that such activities are limited to communication and liaison necessary keep the public informed on matters of public concern, such as notices of Federal contract/grant awards, financial matters, *etc.*

e. Costs identified in sections 1.c and 1.d, if incurred for more than one Federal award or for both sponsored work and other work of the governmental unit, are allowable to the extent that the principles in Attachment A, sections E. ("Direct Costs") and F. ("Indirect Costs") are observed.

f. Unallowable advertising and public relations costs include the following:

(1) All advertising and public relations costs other than as specified in subsections c, d, and e;

(2) Costs of meetings, conventions, convocations, or other events related to other activities of the governmental unit, including:

(a) Costs of displays, demonstrations, and exhibits;

(b) Costs of meeting rooms, hospitality suites, and other special facilities used in conjunction with shows and other special events; and

(c) Salaries and wages of employees engaged in setting up and displaying exhibits, making demonstrations, and providing briefings;

(3) Costs of promotional items and memorabilia, including models, gifts, and souvenirs;

(4) Costs of advertising and public relations designed solely to promote the governmental unit.

5. Attachment B, sections 4, 5, 6 and 7 are revised to read as follows:

4. *Audit costs and related services.*

a. The costs of audits required by, and performed in accordance with, the Single Audit Act, as implemented by Circular A–133, "Audits of States, Local Governments, and Non-Profit Organizations" are allowable. *Also see* 31 U.S.C. 7505(b) and section 230 ("Audit Costs") of Circular A–133.

b. Other audit costs are allowable if included in a cost allocation plan or indirect cost proposal, or if specifically approved by the awarding agency as a direct cost to an award.

c. The cost of agreed-upon procedures engagements to monitor subrecipients who are exempted from A–133 under section 200(d) are allowable, subject to the conditions listed in A–133, section 230(b)(2).

5. *Bad debts.* Bad debts, including losses (whether actual or estimated) arising from uncollectable accounts and other claims, related collection costs, and related legal costs, are unallowable. Costs incurred for telephone services, local and long distance telephone calls, telegrams, postage, messenger, electronic or computer transmittal services and the like are allowable.

6. *Bonding costs.*

a. Bonding costs arise when the Federal Government requires assurance against financial loss to itself or others by reason of the act or default of the governmental unit. They arise also in instances where the governmental unit 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 governmental unit 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.

7. *Communication costs.* Costs incurred for telephone services, local and long distance telephone calls, telegrams, postage, messenger, electronic or computer transmittal services and the like are allowable.

6. Attachment B, section 9. is revised to read as follows:

9. *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* Attachment B, section 22.c.), pension plan reserves (*see* Attachment B, section 8.e.), and post-retirement health and other benefit reserves (*see* Attachment B, section 8.f.) computed using acceptable actuarial cost methods.

7. Attachment B, sections 11. through 15. are revised to read as follows:

11. *Depreciation and use allowances.*

a. Depreciation and use allowances are means of allocating the cost of fixed assets to periods benefiting from asset use. Compensation for the use of fixed assets on hand may be made through depreciation or use allowances. 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.*) except as provided for in subsection g. Except for enterprise funds and internal service funds that are included as part of a State/local cost allocation plan, classes of assets shall be determined on the same basis used for the government-wide financial statements.

b. The computation of depreciation or use allowances shall be based on the acquisition cost of the assets involved. Where actual cost records have not been maintained, a reasonable estimate of the original acquisition cost may be used. The value of an asset donated to the governmental unit by an unrelated third party shall be its fair market value at the time of donation. Governmental or quasi-governmental organizations located within the same State shall not be considered unrelated third parties for this purpose.

c. The computation of depreciation or use allowances 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 governmental unit, or a related donor organization, in satisfaction of a matching requirement.

d. Where the depreciation method is followed, the period of useful service (useful life) established in each case for usable capital assets must take into consideration such factors as type of construction, nature of the equipment used, historical usage patterns, technological developments, and the renewal and replacement policies of the governmental unit followed for the individual items or classes of assets involved. In the absence of clear evidence indicating that the expected consumption of the asset will be significantly greater in the early portions than in the later portions of its useful life, the straight line method of depreciation shall be used.

Depreciation methods once used shall not be changed unless approved by the Federal cognizant or awarding agency. When the depreciation method is introduced for application to an asset previously subject to a use allowance, the annual depreciation charge thereon may not exceed the amount that would have resulted had the depreciation method been in effect from the date of acquisition of the asset. The combination of use allowances and depreciation applicable to the asset shall not exceed the total acquisition cost of the asset or fair market value at time of donation.

e. When the depreciation method is used for buildings, a building's shell may be segregated from the major component of the building (*e.g.*, plumbing system, heating, and air conditioning system, *etc.*) and each major component 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. Where the use allowance method is followed, the use allowance for buildings and improvements (including land improvements, such as paved parking areas, fences, and sidewalks) will be computed at an annual rate not exceeding two percent of acquisition costs. The use allowance for equipment will be computed at an annual rate not exceeding 6⅔ 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 condition, *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, modular furniture, carpeting, *etc.*). Such equipment will be considered as not being permanently fixed to the building if it can be removed without the destruction of, or need for costly or extensive alterations or repairs, to the building or the equipment. Equipment that meets these criteria will be subject to the 6⅔ percent equipment use allowance limitation.

g. A reasonable use allowance may be negotiated for any assets that are considered to be fully depreciated, after taking into consideration the amount of depreciation previously charged to the government, the estimated useful life remaining at the time of negotiation, the effect of any increased maintenance charges, decreased efficiency due to age, and any other factors pertinent to the utilization of the asset for the purpose contemplated.

h. Charges for use allowances or depreciation must be supported by adequate property records. Physical inventories must be taken at least once every two years (a statistical sampling approach is acceptable) to ensure that assets exist, and are in use. Governmental units will manage equipment in accordance with State laws and procedures. When the depreciation method is followed, depreciation records indicating the

amount of depreciation taken each period must also be maintained.

12. *Donations and contributions.*

a. Contributions or donations rendered. Contributions or donations, including cash, property, and services, made by the governmental unit, regardless of the recipient, are unallowable.

b. Donated services received:

(1) Donated or volunteer services may be furnished to a governmental unit 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. However, the value of donated services may be used to meet cost sharing or matching requirements in accordance with the Federal Grant Common Rule.

(2) The value of donated services utilized in the performance of a direct cost activity shall, when material in amount, be considered in the determination of the governmental unit's indirect costs or rate(s) and, accordingly, shall be allocated a proportionate share of applicable indirect costs.

(3) To the extent feasible, donated services will be supported by the same methods used by the governmental unit to support the allocability of regular personnel services.

13. *Employee morale, health, and welfare costs.*

a. The costs of employee information publications, health or first-aid clinics and/or infirmaries, recreational activities, employee counseling services, and any other expenses incurred in accordance with the governmental unit's established practice or custom for the improvement of working conditions, employer-employee relations, employee morale, and employee performance are allowable.

b. Such costs will be equitably apportioned to all activities of the governmental unit. Income generated from any of these activities will be offset against expenses.

14. *Entertainment costs.* Costs of entertainment, including amusement, diversion, and social activities and any costs directly associated with such costs (such as tickets to shows or sports events, meals, lodging, rentals, transportation, and gratuities) are unallowable.

15. *Equipment and other capital expenditures.*

a. For purposes of this section 15, the following definitions apply:

(1) "Capital Expenditures" means expenditures for the acquisition cost of capital assets (equipment, buildings, land), or expenditures to make improvements to capital assets that materially increase their value or useful life. Acquisition cost means the cost of the asset including the cost to put it in place. Acquisition cost for equipment, for example, means the net invoice price of the 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 may be included in, or excluded from the acquisition cost in accordance with the governmental unit's regular accounting practices.

(2) "Equipment" means an article of nonexpendable, tangible personal property having a useful life of more than one year and an acquisition cost which equals or exceeds the lesser of the capitalization level established by the governmental unit for financial statement purposes, or $5000.

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

(4) "General purpose equipment" means equipment, which is not limited to research, medical, scientific or other technical activities. Examples include office equipment and furnishings, modular offices, telephone networks, information technology equipment and systems, air conditioning equipment, reproduction and printing equipment, and motor vehicles.

b. The following rules of allowability shall apply to equipment and other capital expenditures:

(1) Capital expenditures for general purpose equipment, buildings, and land are unallowable as direct charges, except where approved in advance by the awarding agency.

(2) Capital expenditures for special purpose equipment are allowable as direct costs, provided that items with a unit cost of $5000 or more have the prior approval of the awarding agency.

(3) 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.

(4) When approved as a direct charge pursuant to Attachment B, section 15.b.(1), (2), and (3), capital expenditures will be charged in the period in which the expenditure is incurred, or as otherwise determined appropriate and negotiated with the awarding agency. In addition, Federal awarding agencies are authorized at their option to waive or delegate the prior approval requirement.

(5) Equipment and other capital expenditures are unallowable as indirect costs. However, see section 11, Depreciation and use allowance, for rules on the allowability of use allowances or depreciation on buildings, capital improvements, and equipment. Also, see section 37, Rental costs, concerning the allowability of rental costs for land, buildings, and equipment.

(6) The unamortized portion of any equipment written off as a result of a change in capitalization levels may be recovered by continuing to claim the otherwise allowable use allowances or depreciation on the equipment, or by amortizing the amount to be written off over a period of years negotiated with the cognizant agency.

(7) When replacing equipment purchased in whole or in part with Federal funds, the governmental unit may use the equipment to be replaced as a trade-in or sell the property and use the proceeds to offset the cost of the replacement property.

8. Attachment B, sections 19. through 21. are revised to read follows:

19. *General government expenses.*

a. The general costs of government are unallowable (except as provided in Attachment B, section 43, Travel costs). These include:

(1) Salaries and expenses of the Office of the Governor of a State or the chief executive of a political subdivision or the chief executive of federally-recognized Indian tribal government;

(2) Salaries and other expenses of a State legislature, tribal council, or similar local governmental body, such as a county supervisor, city council, school board, *etc.*, whether incurred for purposes of legislation or executive direction;

(3) Costs of the judiciary branch of a government;

(4) Costs of prosecutorial activities unless treated as a direct cost to a specific program if authorized by program statute or regulation (however, this does not preclude the allowability of other legal activities of the Attorney General); and

(5) Costs of other general types of government services normally provided to the general public, such as fire and police, unless provided for as a direct cost under a program statute or regulation.

b. For federally-recognized Indian tribal governments and Councils of Governments (COGs), the portion of salaries and expenses directly attributable to managing and operating

Federal programs by the chief executive and his staff is allowable.

20. *Goods or services for personal use.* Costs of goods or services for personal use of the governmental unit's employees are unallowable regardless of whether the cost is reported as taxable income to the employees.

21. *Idle facilities and idle capacity.*

a. As used in this section 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 governmental unit.

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

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

(4) "Cost of idle facilities or idle capacity" means costs such as maintenance, repair, housing, rent, and other related costs, *e.g.*, insurance, interest, property taxes 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 subsection, costs of idle facilities are allowable for a reasonable period of time, ordinarily not to exceed one year, depending on the initiative taken to use, lease, or dispose of such facilities.

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 that the capacity is reasonably anticipated to be necessary or was originally reasonable and is not subject to reduction or elimination by use on other Federal awards, subletting, renting, or sale, in accordance with sound business, economic, or security practices. Widespread idle capacity throughout an entire facility or among a group of assets having substantially the same function may be considered idle facilities.

9. Attachment B, section 23. is revised to read as follows:

23. *Interest.*

a. Costs incurred for interest on borrowed capital or the use of a governmental unit's own funds, however represented, are unallowable except as specifically provided in this section 23.b. or authorized by Federal legislation.

b. Financing costs (including interest) paid or incurred which are associated with the otherwise allowable costs of building acquisition, construction, or fabrication, reconstruction or remodeling completed on or after October 1, 1980 is allowable subject to the conditions in sections (1) through (4) of this section 23.b. Financing costs (including interest) paid or incurred on or after September 1, 1995 for land or associated with otherwise allowable costs of equipment is allowable, subject to the conditions in (1) through (4).

(1) The financing is provided (from other than tax or user fee sources) by a bona fide third party external to the governmental unit;

(2) The assets are used in support of Federal awards;

(3) Earnings on debt service reserve funds or interest earned on borrowed funds pending payment of the construction or acquisition costs are used to offset the current period's cost or the capitalized interest, as appropriate. Earnings subject to being reported to the Federal Internal Revenue Service under arbitrage requirements are excludable.

(4) For debt arrangements over $1 million, unless the governmental unit makes an initial equity contribution to the asset purchase of 25 percent or more, the governmental unit shall reduce claims for interest cost by an amount equal to imputed interest earnings on excess cash flow, which is to be calculated as follows. Annually, governmental units shall prepare a cumulative (from the inception of the project) report of monthly cash flows that includes inflows and outflows, regardless of the funding source. Inflows consist of depreciation expense, amortization of capitalized construction interest, and annual interest cost. For cash flow calculations, the annual inflow figures shall be divided by the number of months in the year (*i.e.*, usually 12) that the building is in service for monthly amounts. Outflows consist of initial equity contributions, debt principal payments (less the pro rata share attributable to the unallowable costs of land) and interest payments. Where cumulative inflows exceed cumulative outflows, interest shall be calculated on the excess inflows for that period and be treated as a reduction to allowable interest cost. The rate of interest to be used to compute earnings on excess cash flows shall be the three-month Treasury bill closing rate as of the last business day of that month.

(5) Interest attributable to fully depreciated assets is unallowable.

10. Redesignated Attachment B, section 24. is amended by designating the current text as section a. and adding a new section 24.b. to read as follows:

24. *Lobbying.*

* * * * *

b. Executive lobbying costs. Costs incurred in attempting to improperly influence either directly or indirectly, an employee or officer of the Executive Branch of the Federal Government to give consideration or to act regarding a sponsored agreement or a regulatory matter are unallowable. Improper influence means any influence that induces or tends to induce a Federal employee or officer to give consideration or to act regarding a federally-sponsored agreement or regulatory matter on any basis other than the merits of the matter.

11. Attachment B, sections 26. through 30. are revised to read as follows:

26. *Materials and supplies costs.*

a. Costs incurred for materials, supplies, and fabricated parts necessary to carry out a Federal award are allowable.

b. Purchased materials and supplies shall be charged at their actual prices, net of applicable credits. Withdrawals from general stores or stockrooms should be charged at their actual net cost under any recognized method of pricing inventory withdrawals, consistently applied. Incoming transportation charges are a proper part of materials and supplies costs.

c. Only materials and supplies actually used for the performance of a Federal award may be charged as direct costs.

d. Where federally-donated or furnished materials are used in performing the Federal award, such materials will be used without charge.

27. *Meetings and conferences.*

Costs of meetings and conferences, the primary purpose of which is the dissemination of technical information,

are allowable. This includes costs of meals, transportation, rental of facilities, speakers' fees, and other items incidental to such meetings or conferences. *But see* Attachment B, section 14, Entertainment.

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

a. Costs of the governmental unit's memberships in business, technical, and professional organizations are allowable.

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

c. Costs of membership in civic and community, social organizations are allowable as a direct cost with the approval of the Federal awarding agency.

d. Costs of membership in organizations substantially engaged in lobbying are unallowable.

29. *Patent costs.*

a. The following costs relating to patent and copyright matters are allowable:

(1) Cost of preparing disclosures, reports, and other documents required by the Federal award and of searching the art to the extent necessary to make such disclosures;

(2) Cost of 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 Federal Government to be conveyed to the Federal Government; and

(3) General counseling services relating to patent and copyright matters, such as advice on patent and copyright laws, regulations, clauses, and employee agreements (but *see* Attachment B, sections 32, Professional service costs, and 38, Royalties and other costs for use of patents and copyrights).

b. The following costs related to patent and copyright matter are unallowable:

(1) Cost of preparing disclosures, reports, and other documents and of searching the art to the extent necessary to make disclosures not required by the award,

(2) Costs in connection with filing and prosecuting any foreign patent application, or

(3) Any United States patent application, where the Federal award does not require conveying title or a royalty-free license to the Federal Government (but *see* Attachment B, section 38., Royalties and other costs for use of patents and copyrights).

30. *Plant and homeland security costs.*

Necessary and reasonable expenses incurred for routine and homeland security to protect facilities, personnel, and work products are allowable. Such costs include, but are not limited to, wages and uniforms of personnel engaged in security activities; equipment; barriers; contractual security services; consultants; etc. Capital expenditures for homeland and plant security purposes are subject to section 15., Equipment and other capital expenditures, of this circular.

12. Attachment B, section 32. is revised to read as follows:

32. *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 governmental unit, are allowable, subject to sections 32.b. and c. when reasonable in relation to the services rendered and when not contingent upon recovery of the costs from the Federal Government.

In addition, legal and related services are limited under Attachment B, section 10.

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

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

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

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

(4) The impact of Federal awards on the governmental unit's business (*i.e.*, what new problems have arisen).

(5) Whether the proportion of Federal work to the governmental unit's total business is such as to influence the governmental unit in favor of incurring the cost, particularly where the services rendered are not of a continuing nature and have little relationship to work under Federal 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-Federal 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 section 32.b, retainer fees to be allowable must be supported by available or rendered evidence of *bona fide* services available or rendered.

13. Attachment B, section 34. is revised to read as follows:

34. *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. Publication costs also include page charges in professional publications.

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 governmental unit.

c. Page charges for professional journal publications are allowable as a necessary part of research costs where:

(1) The research papers report work supported by the Federal Government; and

(2) The charges are levied impartially on all research papers published by the journal, whether or not by federally-sponsored authors.

14. Attachment B, sections 36. through 39. are revised to read as follows:

36. *Reconversion costs.* Costs incurred in the restoration or rehabilitation of the governmental unit's facilities to approximately the same condition existing immediately prior to commencement of Federal awards, less costs related to normal wear and tear, are allowable.

37. *Rental costs of buildings and equipment.*

a. Subject to the limitations described in sections b. through d. of this section 37, 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. Rental arrangements should be reviewed periodically to determine if circumstances have changed and other options are available.

b. Rental costs under "sale and lease back" arrangements are allowable only up to the amount that would be allowed had the governmental unit continued to own the property. This amount would include expenses such as depreciation or use allowance, maintenance, taxes, and insurance.

c. Rental costs under "less-than-arms-length" leases are allowable only up to the amount (as explained in Attachment B, section 37.b.) that would be allowed had title to the property vested in the

governmental unit. 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 a governmental unit; (ii) governmental units under common control through common officers, directors, or members; and (iii) a governmental unit and a director, trustee, officer, or key employee of the governmental unit or his immediate family, either directly or through corporations, trusts, or similar arrangements in which they hold a controlling interest. For example, a governmental unit may establish a separate corporation for the sole purpose of owning property and leasing it back to the governmental unit.

d. Rental costs under leases which are required to be treated as capital leases under GAAP are allowable only up to the amount (as explained in subsection b) that would be allowed had the governmental unit purchased the property on the date the lease agreement was executed. The provisions of Financial Accounting Standards Board Statement 13, Accounting for Leases, shall be used to determine whether a lease is a capital lease. Interest costs related to capital leases are allowable to the extent they meet the criteria in Attachment B, section 23. Unallowable costs include amounts paid for profit, management fees, and taxes that would not have been incurred had the governmental unit purchased the facility.

38. *Royalties and other costs for the use of patents.*

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 Federal 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-than-arm's-length bargaining, *e.g.*:

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

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

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

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

39. *Selling and marketing.* Costs of selling and marketing any products or services of the governmental unit are unallowable (unless allowed under Attachment B, section 1. as allowable public relations costs or under Attachment B, section 33. as allowable proposal costs.

22. Attachment B, section 41. is revised to read as follows:

41. *Termination costs applicable to Federal awards.*

Termination of awards generally gives rise to the incurrence of costs, or the need for special treatment of costs, which would not have arisen had the Federal 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. The cost of items reasonably usable on the governmental unit's other work shall not be allowable unless the governmental unit 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 governmental unit, the awarding agency should consider the governmental unit's plans and orders for current and scheduled activity.

Contemporaneous purchases of common items by the governmental unit shall be regarded as evidence that such items are reasonably usable on the governmental unit's other work. Any acceptance of common items as allocable to the terminated portion of the Federal 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. If in a particular case, despite all reasonable efforts by the governmental unit, 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 governmental unit to discontinue such costs shall be unallowable.

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

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

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

(3) The loss of useful value for any one terminated Federal award is limited to that portion of the acquisition cost which bears the same ratio to the total acquisition cost as the terminated portion of the Federal award bears to the entire terminated Federal award and other Federal awards for which the special tooling, machinery, or equipment was acquired.

d. Rental costs under unexpired leases are generally allowable where clearly shown to have been reasonably necessary for the performance of the terminated Federal award less the residual value of such leases, if:

(1) the amount of such rental claimed does not exceed the reasonable use value of the property leased for the period of the Federal award and such further period as may be reasonable, and

(2) the governmental unit 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 Federal award, and of reasonable restoration required by the provisions of the lease.

e. Settlement expenses including the following are generally allowable:

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

(a) The preparation and presentation to the awarding agency of settlement claims and supporting data with respect to the terminated portion of the Federal award, unless the termination is for default (*see* section__.44 of the Grants Management Common Rule implementing OMB Circular A–102); and

(b) The termination and settlement of subawards.

(2) Reasonable costs for the storage, transportation, protection, and disposition of property provided by the Federal Government or acquired or produced for the Federal award, except when grantees or contractors are reimbursed for disposals at a predetermined amount in accordance with sections__.31 and __.32 of the

Grants Management Common Rule implementing OMB Circular A–102.

f. Claims under subawards, including the allocable portion of claims which are common to the Federal award, and to other work of the governmental unit are generally allowable.

An appropriate share of the governmental unit's indirect expense may be allocated to the amount of settlements with subcontractors and/or 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.

15. Attachment B, section 43. is revised to read as follows:

43. *Travel costs.*

a. General. 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 governmental unit. Such costs may be charged on an actual cost basis, on a per diem or mileage basis in lieu of actual costs incurred, or on a combination of the two, provided the method used is applied to an entire trip and not to selected days of the trip, and results in charges consistent with those normally allowed in like circumstances in the governmental unit's non-federally-sponsored activities. Notwithstanding the provisions of Attachment B, section 19, General government expenses, travel costs of officials covered by that section are allowable with the prior approval of an awarding agency when they are specifically related to Federal awards.

b. Lodging and subsistence. Costs incurred by employees and officers for travel, including costs of lodging, other subsistence, and incidental expenses, shall be considered reasonable and allowable only to the extent such costs do not exceed charges normally allowed by the governmental unit in its regular operations as the result of the governmental unit's written travel policy. In the absence of an acceptable, written governmental unit policy regarding travel costs, the rates and amounts established under subchapter I of Chapter 57, Title 5, United States Code ("Travel and Subsistence Expenses; Mileage Allowances"), or by the Administrator of General Services, or by the President (or his or her designee) pursuant to any provisions of such subchapter shall apply to travel under Federal awards (48 CFR 31.205–46(a)).

c. Commercial air travel.

(1) Airfare costs in excess of the customary standard commercial airfare (coach or equivalent), Federal Government contract airfare (where authorized and available), or the lowest commercial discount airfare are unallowable except when such accommodations would:

(a) require circuitous routing;

(b) require travel during unreasonable hours;

(c) excessively prolong travel;

(d) result in additional costs that would offset the transportation savings; or

(e) offer accommodations not reasonably adequate for the traveler's medical needs. The governmental unit must justify and document these conditions on a case-by-case basis in order for the use of first-class airfare to be allowable in such cases.

(2) Unless a pattern of avoidance is detected, the Federal Government will generally not question a governmental unit's determinations that customary standard airfare or other discount airfare is unavailable for specific trips if the governmental unit can demonstrate either of the following: (a) that such airfare was not available in the specific case; or (b) that it is the governmental unit's overall practice to make routine use of such airfare.

d. Air travel by other than commercial carrier. Costs of travel by governmental unit-owned, -leased, or -chartered aircraft include the cost of lease, charter, operation (including personnel costs), maintenance, depreciation, insurance, and other related costs. The portion of such costs that exceeds the cost of allowable commercial air travel, as provided for in section 43.c., is unallowable.

e. Foreign travel. 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 receive such approval. For purposes of this provision, "foreign travel" includes any travel outside Canada, Mexico, the United States, and any United States territories and possessions. However, the term "foreign travel" for a governmental unit located in a foreign country means travel outside that country.

C. Amendments to A–122

1. Revise the table of contents to Attachment B as follows:

Attachment B.—Selected Items of Cost

Table of Contents

1. Advertising and public relations costs
2. Advisory councils
3. Alcoholic beverages
4. Audit costs and related services
5. Bad debts
6. Bonding costs
7. Communication costs
8. Compensation for personal services
9. Contingency provisions
10. Defense and prosecution of criminal and civil proceedings, claims, appeals and patent infringement
11. Depreciation and use allowances
12. Donations and contributions
13. Employee morale, health, and welfare costs
14. Entertainment costs
15. Equipment and other capital expenditures
16. Fines and penalties
17. Fund raising and investment management costs
18. Gains and losses on depreciable assets
19. Goods or services for personal use
20. Housing and personal living expenses
21. Idle facilities and idle capacity
22. Insurance and indemnification
23. Interest
24. Labor relations costs
25. Lobbying
26. Losses on other awards or contracts
27. Maintenance and repair costs
28. Materials and supplies costs
29. Meetings and conferences
30. Memberships, subscriptions, and professional activity costs
31. Organization costs
32. Page charges in professional journals
33. Participant support costs
34. Patent costs
35. Plant and homeland security costs
36. Pre-agreement costs
37. Professional services costs
38. Publication and printing costs
39. Rearrangement and alteration costs
40. Reconversion costs
41. Recruiting costs
42. Relocation costs
43. Rental costs of buildings and equipment
44. Royalties and other costs for use of patents and copyrights
45. Selling and marketing
46. Specialized service facilities
47. Taxes
48. Termination costs applicable to Federal awards
49. Training costs
50. Transportation costs
51. Travel costs
52. Trustees

2. Redesignate the following paragraphs in Appendix B:

a. Paragraph 2. is redesignated as paragraph 3.

b. Paragraph 7. is redesignated as paragraph 8.

c. Paragraph 18. is redesignated as paragraph 19.

d. Paragraph 19. is redesignated as paragraph 20.

e. Paragraph 33. is redesignated as paragraph 32.

f. Paragraph 34. is redesignated as paragraph 33.

g. Paragraph 38. is redesignated as paragraph 36.

h. Paragraph 42. is redesignated as paragraph 39.

i. Paragraph 44. is redesignated as paragraph 41.

j. Paragraph 45. is redesignated as paragraph 42.

k. Paragraph 51. is redesignated as paragraph 47.

l. Paragraph 53. is redesignated as paragraph 49.

m. Paragraph 54. is redesignated as paragraph 50.

n. Paragraph 56. is redesignated as paragraph 52.

3. Attachment B, paragraphs 1. and 2. are revised to read as follows:

1. *Advertising and public relations costs.*

a. The term advertising costs means the costs of advertising media and corollary administrative costs. Advertising media include magazines, newspapers, radio and television, direct mail, exhibits, electronic or computer transmittals, and the like.

b. The term public relations includes community relations and means those activities dedicated to maintaining the image of the organization or maintaining or promoting understanding and favorable relations with the community or public at large or any segment of the public.

c. The only allowable advertising costs are those which are solely for:

(1) The recruitment of personnel required for the performance by the organization of obligations arising under a Federal award (*See also* Attachment B, paragraphs 42., Recruiting, and paragraph 43., Relocation costs.);

(2) The procurement of goods and services for the performance of a Federal award;

(3) The disposal of scrap or surplus materials acquired in the performance of a Federal award except when governmental units are reimbursed for disposal costs at a predetermined amount; or

(4) Other specific purposes necessary to meet the requirements of the Federal award.

d. The only allowable public relations costs are:

(1) Costs specifically required by the Federal award;

(2) Costs of communicating with the public and press pertaining to specific activities or accomplishments which result from performance of Federal awards (these costs are considered necessary as part of the outreach effort for the Federal award); or

(3) Costs of conducting general liaison with news media and government public relations officers, to the extent that such activities are limited to communication and liaison necessary keep the public informed on matters of public concern, such as notices of Federal contract/grant awards, financial matters, etc.

e. Costs identified in subparagraphs c and d if incurred for more than one Federal award or for both sponsored work and other work of the organization, are allowable to the extent that the principles in Attachment A, paragraphs B. ("Direct Costs") and C. ("Indirect Costs") are observed.

f. Unallowable advertising and public relations costs include the following:

(1) All advertising and public relations costs other than as specified in paragraphs 1.c., d., and e.;

(2) Costs of meetings, conventions, convocations, or other events related to other activities of the organization, including:

(a) Costs of displays, demonstrations, and exhibits;

(b) Costs of meeting rooms, hospitality suites, and other special facilities used in conjunction with shows and other special events; and

(c) Salaries and wages of employees engaged in setting up and displaying exhibits, making demonstrations, and providing briefings;

(3) Costs of promotional items and memorabilia, including models, gifts, and souvenirs;

(4) Costs of advertising and public relations designed solely to promote the organization.

2. *Advisory councils.*

Costs incurred by advisory councils or committees are allowable as a direct cost where authorized by the Federal awarding agency or as an indirect cost where allocable to Federal awards.

4. Attachment B, paragraphs 4. through 7. are revised to read as follows:

4. *Audit costs and related services.*

a. The costs of audits required by, and performed in accordance with, the Single Audit Act, as implemented by Circular A–133, "Audits of States, Local Governments, and Non-Profit Organizations" are allowable. *Also see* 31 U.S.C. 7505(b) and section 230 ("Audit Costs") of Circular A–133.

b. Other audit costs are allowable if included in an indirect cost rate proposal, or if specifically approved by the awarding agency as a direct cost to an award.

c. The cost of agreed-upon procedures engagements to monitor subrecipients who are exempted from A–133 under section 200(d) are allowable, subject to the conditions listed in A–133, section 230(b)(2).

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

6. *Bonding costs.*

a. Bonding costs arise when the Federal 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.

7. *Communication costs.* Costs incurred for telephone services, local and long distance telephone calls, telegrams, postage, messenger, electronic or computer transmittal services and the like are allowable.

5. In Attachment B, redesignated paragraph 8. is amended by redesignating paragraphs 8.f. through 8.i. as paragraphs 8.g. through 8.j. adding a new paragraph 8.f. and adding a new paragraph 8.k. to read as follows.

8. *Compensation for personal services.*

* * * * *

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

(1) 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.

(2) When employees are performing indirect functions, such as administration, maintenance, or accounting.

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

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

* * * * *

k. Severance pay.

(1) 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

(a) Law,

(b) Employer-employee agreement,

(c) Established policy that constitutes, in effect, an implied agreement on the organization's part, or

(d) Circumstances of the particular employment.

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

(a) 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.

(b) 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 Federal 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 or occurrence.

(c) Costs incurred in certain severance pay packages (commonly known as "a golden parachute" payment) which are in an amount in excess of the normal severance pay paid by the organization to an employee upon termination of employment and are paid to the employee contingent upon a change in management control over, or ownership of, the organization's assets are unallowable.

(d) Severance payments to foreign nationals employed by the organization outside the United States, to the extent that the amount exceeds the customary or prevailing practices for the organization in the United States are unallowable, unless they are necessary for the performance of Federal programs and approved by awarding agencies.

(e) Severance payments to foreign nationals employed by the organization outside the United States due to the termination of the foreign national as a result of the closing of, or curtailment of activities by, the organization in that country, are unallowable, unless they are necessary for the performance of Federal programs and approved by awarding agencies.

6. Attachment B, paragraph 9. is revised to read as follows:

9. *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* paragraphs Attachment B, 8.g.(3) and 22.a.(2)(d); pension funds (*see* paragraph 8.i.): and reserves for normal severance pay (*see* paragraph 8.k.).

7. Attachment B, paragraphs 11. through 15. are revised to read as follows:

11. *Depreciation and use allowances.*

a. Compensation for the use of buildings, other capital improvements, and equipment on hand may be made through use allowance or depreciation. However, except as provided in Attachment B, paragraph 11.f., 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 requirement.

d. 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 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.

e. 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 subparagraph d, 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 Federal 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. 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 6⅔ 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, modular furniture, 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 6⅔ percent equipment use allowance limitation.

h. 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.

12. *Donations and contributions.*

a. Contributions or donations rendered. Contributions or donations, including cash, property, and services, made by the organization, regardless of the recipient, are unallowable.

b. Donated services received:

(1) Donated or volunteer services may be furnished to a 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. However, the value of donated services may be used to meet cost sharing or matching requirements in accordance with OMB Circular A–110.

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

(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 Sec. __.23 of Circular 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.

c. Donated goods or space.

(1) Donated goods; *i.e.*, expendable personal property/supplies, and donated use of space may be furnished to a 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 Circular A–110. Where donations are treated as indirect costs, indirect cost rates will separate the value of the donations so that reimbursement will not be made.

13. *Employee morale, health, and welfare costs.*

a. The costs of employee information publications, health or first-aid clinics and/or infirmaries, recreational activities, employee counseling services, and any 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.

b. 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.

14. *Entertainment costs.*

Costs of entertainment, including amusement, diversion, and social activities and any costs directly associated with such costs (such as tickets to shows or sports events, meals, lodging, rentals, transportation, and gratuities) are unallowable.

15. *Equipment and other capital expenditures.*

a. For purposes of this subparagraph, the following definitions apply:

(1) "Capital Expenditures" means expenditures for the acquisition cost of capital assets (equipment, buildings, land), or expenditures to make improvements to capital assets that materially increase their value or useful life. Acquisition cost means the cost of the asset including the cost to put it in place. Acquisition cost for equipment, for example, means the net invoice price of the 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 may be included in, or excluded from the acquisition cost in accordance with the organization's regular accounting practices.

(2) "Equipment" means an article of nonexpendable, tangible personal property having a useful life of more than one year and an acquisition cost which equals or exceeds the lesser of the capitalization level established by the organization for financial statement purposes, or $5000.

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

(4) "General purpose equipment" means equipment, which is not limited to research, medical, scientific or other technical activities. Examples include office equipment and furnishings, modular offices, telephone networks, information technology equipment and systems, air conditioning equipment, reproduction and printing equipment, and motor vehicles.

b. The following rules of allowability shall apply to equipment and other capital expenditures:

(1) Capital expenditures for general purpose equipment, buildings, and land are unallowable as direct charges, except where approved in advance by the awarding agency.

(2) Capital expenditures for special purpose equipment are allowable as direct costs, provided that items with a unit cost of $5000 or more have the prior approval of the awarding agency.

(3) 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.

(4) When approved as a direct charge pursuant to this paragraph 15.b.(1), (2), and (3), capital expenditures will be charged in the period in which the expenditure is incurred, or as otherwise determined appropriate by and negotiated with the awarding agency.

(5) Equipment and other capital expenditures are unallowable as indirect costs. However, *see* Attachment B, paragraph 11., Depreciation and use allowance, for rules on the allowability of use allowances or depreciation on buildings, capital improvements, and equipment. Also, *see* Attachment B, paragraph 44., Rental costs of buildings and equipment, for rules on the allowability of rental costs for land, buildings, and equipment.

(6) The unamortized portion of any equipment written off as a result of a change in capitalization levels may be recovered by continuing to claim the

otherwise allowable use allowances or depreciation on the equipment, or by amortizing the amount to be written off over a period of years negotiated with the cognizant agency.

8. Attachment B, paragraphs 17. and 18., are revised to read as follows:

17. *Fund raising and investment management costs.*

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

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

c. Fundraising and investment activities shall be allocated an appropriate share of indirect costs under the conditions described in subparagraph B.3 of Attachment A.

18. *Gains and losses on depreciable 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 account and is reflected in the depreciation allowable under Attachment B, paragraph 11.

(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 Attachment B, paragraph 22.

(d) Compensation for the use of the property was provided through use allowances in lieu of depreciation in accordance with paragraph 11.

(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 subparagraph a shall be excluded in computing award costs.

9. Attachment B, paragraph 21. is revised to read as follows:

21. *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: (a) That which a facility could achieve under 100 percent operating time on a one-shift basis less operating interruptions resulting from time lost for repairs, setups, unsatisfactory materials, and other normal delays; and (b) the extent to which the facility was actually used to meet demands during the accounting period. A multi-shift basis should be used if it can be shown that this amount of usage would normally be expected for the type of facility involved.

(4) "Cost of idle facilities or idle capacity" means costs such as maintenance, repair, housing, rent, and other related costs, *e.g.*, insurance, interest, property taxes 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 on the initiative taken to use, lease, or dispose of such facilities.

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 that the capacity is reasonably anticipated to be necessary or was originally reasonable and is not subject to reduction or elimination by use on other Federal awards, subletting, renting, or sale, in accordance with sound business, economic, or security practices. Widespread idle capacity throughout an entire facility or among a group of assets having substantially the same function may be considered idle facilities.

10. Attachment B, paragraph 23. is revised to read as follows:

23. *Interest.* a. Costs incurred for interest on borrowed capital, temporary use of endowment funds, or the use of the organization's own funds, however represented, are unallowable. However, interest on debt incurred after September 29, 1995 to acquire or replace capital assets (including renovations, alterations, equipment, land, and capital assets acquired through capital leases), acquired after September 29, 1995 and used in support of Federal awards is allowable, provided that:

(1) For facilities acquisitions (excluding renovations and alterations) costing over $10 million where the Federal Government's reimbursement is expected to equal or exceed 40 percent of an asset's cost, the organization prepares, prior to the acquisition or replacement of the capital asset(s), a justification that demonstrates the need for the facility in the conduct of federally-sponsored activities. Upon request, the needs justification must be provided to the Federal agency with cost cognizance authority as a prerequisite to the continued allowability of interest on debt and depreciation related to the facility. The needs justification for the acquisition of a facility should include, at a minimum, the following:

(a) A statement of purpose and justification for facility acquisition or replacement;

(b) A statement as to why current facilities are not adequate;

(c) A statement of planned future use of the facility;

(d) A description of the financing agreement to be arranged for the facility;

(e) A summary of the building contract with estimated cost information and statement of source and use of funds;

(f) A schedule of planned occupancy dates.

(2) For facilities costing over $500,000, the non-profit organization prepares, prior to the acquisition or replacement of the facility, a lease/purchase analysis in accordance with the provisions of Sections __.30 through __.37 of Circular A–110, which shows that a financed purchase or capital lease is less costly to the organization than other leasing alternatives, on a net present value basis. Discount rates used should be equal to the non-profit organization's anticipated interest rates and should be no higher than the fair market rate available to the non-profit organization from an unrelated ("arm's

length") third-party. The lease/purchase analysis shall include a comparison of the net present value of the projected total cost comparisons of both alternatives over the period the asset is expected to be used by the non-profit organization. The cost comparisons associated with purchasing the facility shall include the estimated purchase price, anticipated operating and maintenance costs (including property taxes, if applicable) not included in the debt financing, less any estimated asset salvage value at the end of the period defined above. The cost comparison for a capital lease shall include the estimated total lease payments, any estimated bargain purchase option, operating and maintenance costs, and taxes not included in the capital leasing arrangement, less any estimated credits due under the lease at the end of the period defined above. Projected operating lease costs shall be based on the anticipated cost of leasing comparable facilities at fair market rates under rental agreements that would be renewed or reestablished over the period defined above, and any expected maintenance costs and allowable property taxes to be borne by the non-profit organization directly or as part of the lease arrangement.

(3) The actual interest cost claimed is predicated upon interest rates that are no higher than the fair market rate available to the non-profit organization from an unrelated ("arm's length") third party.

(4) Investment earnings, including interest income, on bond or loan principal, pending payment of the construction or acquisition costs, are used to offset allowable interest cost. Arbitrage earnings reportable to the Internal Revenue Service are not required to be offset against allowable interest costs.

(5) Reimbursements are limited to the least costly alternative based on the total cost analysis required under subparagraph (b). For example, if an operating lease is determined to be less costly than purchasing through debt financing, then reimbursement is limited to the amount determined if leasing had been used. In all cases where a lease/purchase analysis is performed, Federal reimbursement shall be based upon the least expensive alternative.

(6) Organizations are also subject to the following conditions:

(a) Interest on debt incurred to finance or refinance assets acquired before or reacquired after September 29, 1995, is not allowable.

(b) Interest attributable to fully depreciated assets is unallowable.

(c) For debt arrangements over $1 million, unless the non-profit organization makes an initial equity contribution to the asset purchase of 25 percent or more, non-profit organizations shall reduce claims for interest expense by an amount equal to imputed interest earnings on excess cash flow, which is to be calculated as follows. Annually, non-profit organizations shall prepare a cumulative (from the inception of the project) report of monthly cash flows that includes inflows and outflows, regardless of the funding source. Inflows consist of depreciation expense, amortization of capitalized construction interest, and annual interest expense. For cash flow calculations, the annual inflow figures shall be divided by the number of months in the year (usually 12) that the building is in service for monthly amounts. Outflows consist of initial equity contributions, debt principal payments (less the pro rata share attributable to the unallowable costs of land) and interest payments. Where cumulative inflows exceed cumulative outflows, interest shall be calculated on the excess inflows for that period and be treated as a reduction to allowable interest expense. The rate of interest to be used to compute earnings on excess cash flows shall be the three month Treasury Bill closing rate as of the last business day of that month.

(d) Substantial relocation of federally-sponsored activities from a facility financed by indebtedness, the cost of which was funded in whole or part through Federal reimbursements, to another facility prior to the expiration of a period of 20 years requires notice to the Federal cognizant agency. The extent of the relocation, the amount of the Federal participation in the financing, and the depreciation and interest charged to date may require negotiation and/or downward adjustments of replacement space charged to Federal programs in the future.

(e) The allowable costs to acquire facilities and equipment are limited to a fair market value available to the non-profit organization from an unrelated ("arm's length") third party.

b. For non-profit organizations subject to "full coverage" under the Cost Accounting Standards (CAS) as defined at 48 CFR 9903.201, the interest allowability provisions of subparagraph a do not apply. Instead, these organizations' sponsored agreements are subject to CAS 414 (48 CFR 9903.414), cost of money as an element of the cost of facilities capital, and CAS 417 (48 CFR 9903.417), cost of money as an element of the cost of capital assets under construction.

c. The following definitions are to be used for purposes of this paragraph:

(1) Re-acquired assets means assets held by the non-profit organization prior to September 29, 1995 that have again come to be held by the organization, whether through repurchase or refinancing. It does not include assets acquired to replace older assets.

(2) Initial equity contribution means the amount or value of contributions made by organizations for the acquisition of the asset or prior to occupancy of facilities.

(3) Asset costs means the capitalizable costs of an asset, including construction costs, acquisition costs, and other such costs capitalized in accordance with GAAP.

11. Attachment B, paragraph 25. is amended by adding a new sub-paragraph d. at the end to read as follows:

25. *Lobbying.*

* * * * *

d. Executive lobbying costs. Costs incurred in attempting to improperly influence either directly or indirectly, an employee or officer of the Executive Branch of the Federal Government to give consideration or to act regarding a sponsored agreement or a regulatory matter are unallowable. Improper influence means any influence that induces or tends to induce a Federal employee or officer to give consideration or to act regarding a federally-sponsored agreement or regulatory matter on any basis other than the merits of the matter.

12. Attachment B, paragraph 26. is amended by revising the title to read as follows:

26. *Losses on other awards or contracts.*

* * * * *

13. Attachment B, paragraphs 27. through 30. are revised to read as follows:

27. *Maintenance and repair costs.*

Costs incurred for necessary maintenance, repair, or upkeep of buildings and equipment (including Federal 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* Attachment B paragraph 15.).

28. *Materials and supplies costs.*

a. Costs incurred for materials, supplies, and fabricated parts necessary to carry out a Federal award are allowable.

b. Purchased materials and supplies shall be charged at their actual prices, net of applicable credits. Withdrawals from general stores or stockrooms should be charged at their actual net cost under any recognized method of pricing inventory withdrawals, consistently applied. Incoming transportation charges are a proper part of materials and supplies costs.

c. Only materials and supplies actually used for the performance of a Federal award may be charged as direct costs.

d. Where federally-donated or furnished materials are used in performing the Federal award, such materials will be used without charge.

29. *Meetings and conferences.*

Costs of meetings and conferences, the primary purpose of which is the dissemination of technical information, are allowable. This includes costs of meals, transportation, rental of facilities, speakers' fees, and other items incidental to such meetings or conferences. But *see* Attachment B, paragraphs 14., Entertainment, and 34., Participant support costs.

30. *Memberships, subscriptions, and professional activities.*

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

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

c. Costs of membership in any civic or community organization are allowable with prior approval by Federal cognizant agency.

d. Costs of membership in any country club or social or dining club or organization are unallowable.

14. Attachment B, paragraphs 34. and 35. are revised to read as follows:

34. *Patent costs.*

a. The following costs relating to patent and copyright matters are allowable:

(1) Cost of preparing disclosures, reports, and other documents required by the Federal award and of searching the art to the extent necessary to make such disclosures;

(2) Cost of 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 Federal Government to be conveyed to the Federal Government; and

(3) General counseling services relating to patent and copyright matters, such as advice on patent and copyright laws, regulations, clauses, and employee agreements (but *see* Attachment B, paragraphs 37., Professional service costs, and 44., Royalties and other costs for use of patents and copyrights).

b. The following costs related to patent and copyright matter are unallowable:

(1) Cost of preparing disclosures, reports, and other documents and of searching the art to the extent necessary to make disclosures not required by the award.

(2) Costs in connection with filing and prosecuting any foreign patent application, or any United States patent application, where the Federal award does not require conveying title or a royalty-free license to the Federal Government (but *see* Attachment B, paragraph 44., Royalties and other costs for use of patents and copyrights).

35. *Plant and homeland security costs.*

Necessary and reasonable expenses incurred for routine and homeland security to protect facilities, personnel, and work products are allowable. Such costs include, but are not limited to, wages and uniforms of personnel engaged in security activities; equipment; barriers; contractual security services; consultants; *etc.* Capital expenditures for homeland and plant security purposes are subject to Attachment B, paragraph 15., Equipment and other capital expenditures, of this circular.

15. In Attachment B, redesignated paragraph 36. is amended by revising the title to read as follows:

36. *Pre-agreement costs.*

* * * * *

16. Attachment B, paragraphs 37. and 38. are revised to read as follows:

37. *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 subparagraphs b. and c. of this paragraph 37. when reasonable in relation to the services rendered and when not contingent upon recovery of the costs from the Federal Government.

In addition, legal and related services are limited under Attachment B, paragraph 10.

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

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

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

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

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

(5) Whether the proportion of Federal 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 Federal 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-Federal 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 this Attachment B, paragraph 37.b., retainer fees to be allowable must be supported by evidence of bona fide services available or rendered.

38. *Publication and printing costs.*

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

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. Page charges for professional journal publications are allowable as a necessary part of research costs where:

(1) The research papers report work supported by the Federal Government; and

(2) The charges are levied impartially on all research papers published by the journal, whether or not by federally-sponsored authors.

17. Attachment B, paragraph 40 is revised to read as follows:

40. *Reconversion costs.* Costs incurred in the restoration or rehabilitation of the organization's facilities to approximately the same condition

existing immediately prior to commencement of Federal awards, less costs related to normal wear and tear, are allowable.

18. Attachment B, paragraphs 43. through 46., are revised to read as follows:

43. *Rental costs of buildings and equipment.*

a. Subject to the limitations described in subparagraphs b. through d. of this paragraph 43., 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. Rental arrangements should be reviewed periodically to determine if circumstances have changed and other options are available.

b. Rental costs under "sale and lease back" arrangements are allowable only up to the amount that would be allowed had the organization continued to own the property. This amount would include expenses such as depreciation or use allowance, maintenance, taxes, and insurance.

c. Rental costs under "less-than-arm's-length" leases are allowable only up to the amount (as explained in subparagraph b. of this paragraph 43.) that would be allowed had title to the property vested in the organization. For this purpose, a less-than-arm's-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:

(1) Divisions of an organization;

(2) Organizations under common control through common officers, directors, or members; and

(3) An organization and a director, trustee, officer, or key employee of the organization or his immediate family, either directly or through corporations, trusts, or similar arrangements in which they hold a controlling interest.

For example, an organization may establish a separate corporation for the sole purpose of owning property and leasing it back to the organization.

d. Rental costs under leases which are required to be treated as capital leases under GAAP are allowable only up to the amount (as explained in subparagraph b. of this paragaph 43.) that would be allowed had the organization purchased the property on the date the lease agreement was executed. The provisions of Financial Accounting Standards Board Statement 13, Accounting for Leases, shall be used to determine whether a lease is a capital lease. Interest costs related to capital leases are allowable to the extent they meet the criteria in Attachment B, paragraph 23. Unallowable costs include amounts paid for profit, management fees, and taxes that would not have been incurred had the organization purchased the facility.

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

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

(1) The Federal 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 arrived at as a result of less-than-arm's-length bargaining, *e.g.:*

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

(2) Royalties paid to unaffiliated parties, including corporations, under an agreement entered into in contemplation that a Federal 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.

45. *Selling and marketing.* Costs of selling and marketing any products or services of the organization are unallowable (unless allowed under Attachment B, paragraph 1, as allowable public relations cost. However, these costs are allowable as direct costs, with prior approval by awarding agencies, when they are necessary for the performance of Federal programs.

46. *Specialized service facilities.*

a. The costs of services provided by highly complex or specialized facilities operated by the organization, such as computers, wind tunnels, and reactors are allowable, provided the charges for the services meet the conditions of either 46.b. or c. and, in addition, take into account any items of income or Federal financing that qualify as applicable credits under Attachment A, paragraph 5, of this circular.

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:

(1) Does not discriminate against federally-supported activities of the organization, including usage by the organization for internal purposes; and

(2) Is designed to recover only the aggregate costs of the services. The costs of each service shall consist normally of both its direct costs and its allocable share of all indirect costs. Rates shall be adjusted at least biennially, and shall take into consideration over/under applied costs of the previous period(s).

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

d. Under some extraordinary circumstances, where it is in the best interest of the Federal Government and the organization to establish alternative costing arrangements, such arrangements may be worked out with the cognizant Federal agency.

19. Attachment B, paragraph 48, is revised to read as follows:

48. *Termination costs applicable to Federal awards.*

Termination of awards generally gives rise to the incurrence of costs, or the need for special treatment of costs, which would not have arisen had the Federal 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. 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 Federal 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. 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 of special tooling, machinery, and is generally allowable if:

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

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

(3) The loss of useful value for any one terminated Federal award is limited to that portion of the acquisition cost which bears the same ratio to the total acquisition cost as the terminated portion of the Federal award bears to the entire terminated Federal award and other Federal awards for which the special tooling, special machinery, or equipment was acquired.

d. Rental costs under unexpired leases are generally allowable where clearly shown to have been reasonably necessary for the performance of the terminated Federal award less the residual value of such leases, if:

(1) the amount of such rental claimed does not exceed the reasonable use value of the property leased for the period of the Federal award and such further period as may be reasonable, and

(2) the organization makes all reasonable efforts to terminate, assign, settle, or otherwise reduce the cost of such lease. There also may be included the cost of alterations of such leased property, provided such alterations were necessary for the performance of the Federal award, and of reasonable restoration required by the provisions of the lease.

e. Settlement expenses including the following are generally allowable:

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

(a) The preparation and presentation to the awarding agency of settlement claims and supporting data with respect to the terminated portion of the Federal award, unless the termination is for default (*see* section __.61 of Circular 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 Federal Government or acquired or produced for the Federal award, except when grantees or contractors are reimbursed for disposals at a predetermined amount in accordance with sections __.32 through __.37 of Circular A–110.

(3) Indirect costs related to salaries and wages incurred as settlement expenses in subparagraphs e.(1) and (2) of this paragraph 48. Normally, such indirect costs shall be limited to fringe benefits, occupancy cost, and immediate supervision.

f. Claims under sub awards, including the allocable portion of claims which are common to the Federal 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 subcontractors and/or 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.

20. In Attachment B, redesignated paragraph 49. is amended by revising the title to read as follows:

49. *Training costs.*

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21. Attachment B, paragraph 51. is revised to read as follows:

51. *Travel costs.*

a. General. 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. Such costs may be charged on an actual cost basis, on a per diem or mileage basis in lieu of actual costs incurred, or on a combination of the two, provided the method used is applied to an entire trip and not to selected days of the trip, and results in charges consistent with those normally allowed in like circumstances in the organization's non-federally-sponsored activities.

b. Lodging and subsistence. Costs incurred by employees and officers for travel, including costs of lodging, other subsistence, and incidental expenses, shall be considered reasonable and allowable only to the extent such costs do not exceed charges normally allowed by the organization in its regular operations as the result of the organization's written travel policy. In the absence of an acceptable, written organization policy regarding travel costs, the rates and amounts established under subchapter I of Chapter 57, Title 5, United States Code ("Travel and Subsistence Expenses; Mileage Allowances"), or by the Administrator of General Services, or by the President (or his or her designee) pursuant to any provisions of such subchapter shall apply to travel under Federal awards (48 CFR 31.205–46(a)).

c. Commercial air travel.

(1) Airfare costs in excess of the customary standard commercial airfare (coach or equivalent), Federal Government contract airfare (where authorized and available), or the lowest commercial discount airfare are unallowable except when such accommodations would:

(a) Require circuitous routing;

(b) Require travel during unreasonable hours;

(c) Excessively prolong travel;

(d) Result in additional costs that would offset the transportation savings; or

(e) Offer accommodations not reasonably adequate for the traveler's medical needs. The organization must justify and document these conditions on a case-by-case basis in order for the use of first-class airfare to be allowable in such cases.

(2) Unless a pattern of avoidance is detected, the Federal Government will generally not question an organization's determinations that customary standard airfare or other discount airfare is unavailable for specific trips if the organization can demonstrate either of the following: (a) that such airfare was not available in the specific case; or (b) that it is the organization's overall practice to make routine use of such airfare.

d. Air travel by other than commercial carrier. Costs of travel by organization-owned, -leased, or -chartered aircraft include the cost of lease, charter, operation (including personnel costs), maintenance, depreciation, insurance, and other related costs. The portion of such costs that exceeds the cost of allowable commercial air travel, as provided for in paragraph c. of this paragraph 51., is unallowable.

e. Foreign travel. 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 receive such approval. For purposes of this provision, "foreign travel" includes any travel outside Canada, Mexico, the United States, and any United States territories and possessions. However, the term "foreign travel" for an organization located in a foreign country means travel outside that country.

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