

# Classification of Subrecipient Costs

April 21, 1988

MEMORANDUM FOR: Kenneth J. Finlayson, Regional Administrator-  
Regional Housing Commissioner, 3S

ATTENTION: John J. Kane, Director  
Office of Community Planning and Development, 3C

FROM: Jack R. Stokvis, General Deputy Assistant Secretary for Community Planning and Development,  
CD

## **SUBJECT: Classification of Subrecipient Costs as Program Delivery or General Administration**

This is in response to the memorandum of December 18, 1987, from John Kane on the above subject. The issue raised in the memorandum is whether under the current CDBG regulations it is permissible for the City of Philadelphia to distribute overhead costs, such as rent, supplies and equipment, to program delivery and general administration.

That practice does not violate the CDBG regulations. The purpose of the language in 24 CFR 570.206(e) is to require the use of a cost allocation plan in distributing indirect costs to the CDBG program and other funding sources. It was not meant to require that all indirect costs be charged as general administration. All costs of carrying out an activity eligible under 24 CFR 570.201 through 570.204, including indirect costs, should be charged to the applicable activity and not to general administration.

The memorandum also requested comments on the propriety of the method used by a subrecipient to allocate indirect costs. It cites a case in which a subrecipient is carrying out more than one CDBG activity. The subrecipient has identified the overhead (indirect) costs allocable to the CDBG program as a whole, but now needs to further allocate the costs to each CDBG activity (i.e., the ultimate cost objective). The method used by the subrecipient was to apportion the overhead costs based on the ratio of each activity's budgeted costs to the total CDBG budget.

The use of budgeted costs as an allocation basis is not recommended because it does not always assure the most equitable distribution of indirect costs. We suggest that the subrecipient use one of the two preferred allocation bases described in OMB Circulars A-87 and A-122 which are (1) direct salaries and wages and (2) total direct program cost. A different base may be used if the subrecipient can show that it provides a more equitable distribution of the indirect cost than either of the two listed above.

A subrecipient should be cautioned not to use "total direct program costs" as the allocation base if the direct costs for an activity "flow through" the organization with very little managerial effort required on the part of the subrecipient. Such a case would result in an inequitable and excessive amount of indirect costs allocated to the "flow through" activity. For this reason, "direct salaries and wages" is the most commonly used allocation base in indirect cost proposals.

I would like to commend Mr. Kane and his staff for the quality of the incoming memorandum. The issue was thoroughly and clearly described and the attachment greatly aided our understanding of the process being used by the City to charge costs to program delivery and general administration.

If there are any further questions on the allocation of indirect costs, please contact Pat Patterson in the Financial Management Division at FTS 755-1871.