

Top Seven Facts About OMB Circular A-87, Cost Principles for State, Local and Indian Tribal Governments



1. **OMB Circular A-87 provides principles used to establish *allowable costs* incurred by state and local governments under grants, cost-reimbursement contracts and other agreements (“Federal Awards”) with the Federal Government; these principles operate under the following assumptions:**
 - a. The Federal Government is expected to pay its fair share of the state and local governments’ operating cost in carrying out the Federal awards, as defined in the program rules issued by the Federal agency making the award (e.g., HUD);
 - b. A-87 **does not** prescribe how state or local governments should organize or carry out the work under their Federal awards beyond stating that they should use “sound management practices”;
 - c. A-87 is not applicable to awards or subawards to publicly-financed colleges or universities (OMB Circular A-21, Cost Principles for Educational Institutions, applies to these entities) or hospitals (which are governed by the specific grants awarded to the hospitals);
 - d. Subawards of Federal funds by state or local governments to other entities are subject to the Federal cost principles applicable to the specific type of subgrantee. So, for example, if the subgrantee is a local government (as in the regular CDBG Program, A-87 would apply, while if the subaward was to a nonprofit corporation, OMB Circular A-122 (Cost Principles for Nonprofit Organizations) would apply.

2. **According to A-87, to be allowable under Federal awards, costs must:**
 - a. Be necessary and reasonable to carry out the Federal award;
 - b. Be allocable to Federal awards under the rules of A-87 (as detailed in # 3 below);
 - c. Be authorized (or not prohibited) under state or local laws or rules;
 - d. Conform to other limitations or exclusions in A-87, Federal law or rules, or other governing regulations;
 - e. Be consistent with policies and rules applicable to Federal awards and other activities of state or local governments;

- f. Be treated consistently (for example, not assigned as a direct cost if other costs incurred for the same purposes are treated as indirect costs);
- g. Be determined in accordance with generally accepted accounting principles;
- h. Not be used to meet cost sharing or matching requirements of any Federal award (unless the OMB has allowed a specific program to do so, such as the Indian Community Development Block Grant program);
- i. Be net of applicable credits (for example, the agency must take advantage of discounts, rebates, refunds, recoveries and adjustments); and
- j. Be adequately documented.

3. Allocation of Costs: OMB Circular A-87 defines acceptable methods of allocating costs for central service administration and indirect costs. Typical central administrative costs may include central accounting services, information technology services, human resources functions, general program management and oversight. Generally, the costs of these central functions are shared by several programs, and agencies must develop a cost allocation plan to show how those costs will be shared among the various programs. The cost allocation plan must ensure that:

- a. The cost is allocated in accordance with relative benefits received;
- b. All activities that benefit from the state or local government's indirect cost (including unallowable activities and services) receive an appropriate allocation of indirect cost; and
- c. Any cost that may be allocated under A-87 may not be charged to other Federal awards to overcome fund deficiencies or any other reasons (for example, if one Federally funded program does not have sufficient funds to cover its share of indirect costs, those costs may not be charged to another Federal program).

Central services provided to a program funded by a Federal award can either be billed on a fee-for-service basis (such as for computer services, transportation, fringe benefits), or on an allocated basis (such as for general accounting, procurement or personnel administration services).

4. Direct Costs: Under OMB Circular A-87, certain direct costs are billable to Federal awards. Listed below are the types of direct costs allowed under A-87. However, there are a number of further restrictions placed on eligible activities or costs under the CDBG program, and all CDBG expenditures must comply with both requirements. A-87 allowable costs include:

- a. Salaries or wages to employees for time devoted to the performance of the award;
- b. Materials and supplies bought and used specifically for the purpose of the award;

- c. Equipment and other approved capital expenditures (consistent with the rules of the specific Federal program) – after all, most equipment costs *not* eligible under CDBG;
- d. Travel expenses incurred to carry out the award (e.g., to attend training on some aspect of program requirements under the award) consistent with government per diem rates and airfare restrictions.

- 5. **When a cost allocation plan or indirect cost proposal is required by OMB Circular A-87, it must be certified to by the chief financial officer of the governmental unit and maintained on file for review. The method used to distribute costs of services must be documented and retained for review. Agencies should review the plan regularly (at least annually) to ensure that the actual allocations are adequate. Attachment E to OMB Circular A-87 provides specific instructions on the methods used to establish indirect cost rates, and how proposals for indirect cost rates will be developed, submitted and documented.**
- 6. **When services are provided by one department to another within a governmental unit, it is permitted to include both allowable direct costs plus a pro-rated share of indirect costs. Ten percent of direct salary/wage for providing the service may be used instead of determining actual indirect cost. For example, in a large CDBG Entitlement community, the Community Development Department may “purchase” its Environmental Reviews from the Environmental Protection Department. The actual costs of conducting the review along with a ten percent indirect cost could be paid by CDBG to the Environmental Protection Department for each Environmental Review conducted.**
- 7. **Attachment B to A-87 provides 27 pages of specific guidance on what elements of a wide range of cost categories are allowable; it also identifies categories of expenses that are not allowable. The following types of costs are not allowable:**
 - a. Alcoholic beverages;
 - b. Bad debts;
 - c. Contingency provisions/reserves (except for those related to fringe benefits and determined using acceptable actuarial methods);
 - d. Defense of civil or criminal fraud charges;
 - e. Entertainment, which includes tickets to shows, sports events, meals, lodging, rentals, transportation, and gratuities; this has been further defined to include providing coffee at meetings;
 - f. Fund-raising to obtain capital or obtain contributions;
 - g. Goods or services for personal use even if the cost is reported as taxable income for the individual;

- h. Lobbying; and
- i. Selling and marketing products or services (for economic development activities funded under CDBG, the marketing of the product will have to be funded by the business or organization, not by CDBG funds).