

# OMB CIRCULAR A-21

## OFFICE OF MANAGEMENT AND BUDGET

### Cost Principles for Educational Institutions

**AGENCY:** Office of Management and Budget.

**ACTION:** Final Revision and Recompilation of OMB Circular A-21.

**SUMMARY:** The Office of Management and Budget (OMB) revises OMB Circular A-21, "Cost Principles for Educational Institutions," by incorporating four Cost Accounting Standards applicable to educational institutions, issued by the Cost Accounting Standards Board (CASB) on November 8, 1994 (59 FR 55746), and extending these standards to all sponsored agreements. The revision also: requires certain large institutions to disclose their cost accounting practices by the submission of a Disclosure Statement prescribed by the CASB; amends the definition of equipment; eliminates in 1998 the use of special cost studies to allocate utility, library and student services costs; and, requires the use of fixed facilities and administrative cost rates for the life of sponsored agreements. Further, the revision establishes cost negotiation cognizant agency responsibilities, replaces the term "indirect costs" with "facilities and administrative costs" (to describe more accurately the various cost components of sponsored agreements), clarifies the policy for a change from use allowance to depreciation, adds criteria to interest allowability, and disallows tuition benefits for employee family members. Finally, the revision rescinds OMB Circular A-88, "Indirect Cost Rates, Audits, and Audit Follow-up at Educational Institutions," in its entirety. The recompilation of Circular A-21 in its entirety appears after the revision.

**EFFECTIVE DATE:** The effective date of this revision is the issuance date of this revision in the Federal Register, unless otherwise noted within this revision.

**FOR FURTHER INFORMATION:** Educational institutions should contact the educational institution's cognizant Federal agency. Federal agencies should

contact Gilbert Tran, Office of Financial Federal Financial Management, Office of Management and Budget, (202) 395-3993.

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## **SUPPLEMENTARY INFORMATION:**

**A. Purpose of Circular A-21.** Office of Management and Budget (OMB) Circular A-21, "Cost Principles for Educational Institutions," establishes principles for determining costs applicable to Federal grants, contracts, and other sponsored agreements with educational institutions.

**B. Recent Prior Revisions.** Circular A-21 was last amended in 1991 and 1993 (56 FR 50224 of 10/1/91 and 58 FR 39996 of 7/15/93, respectively). The 1991 revisions made certain specified costs unallowable for Federal reimbursement and placed a limit on the amount of reimbursable administrative costs. That revision also required a certification to accompany each rate proposal. The 1991 revisions also added Exhibit A containing a list of colleges and universities subject to Section J.12.F, Depreciation and Use Allowance. The 1993 revisions further clarified and standardized the Circular's principles for determining allowable costs.

**C. Current Revisions.** On February 6, 1995, OMB proposed revisions in 60 FR 7104 and 60 FR 7106. In 60 FR 7104, OMB proposed the extension of the four cost accounting standards (CAS) applicable to educational institutions to all sponsored agreements and an amendment to the definition of equipment. In 60 FR 7106, OMB proposed eight additional revisions, including the rescission of OMB Circular A-88, "Indirect Cost Rate, Audits, and Audit Follow-up at Educational Institutions," and mentioned six other revisions for future consideration.

Circular A-21 is revised to:

1. Incorporate the four CAS (48 CFR 9905) and the Disclosure Statement (the Cost Accounting Standards Board's (CASB) form DS-2) and associated administrative requirements promulgated by the CASB for educational institutions. This action will extend the four CAS to all sponsored agreements (see Sections C.10, 11, 12

and 13 and Appendix A) and extend the applicability of the DS-2 (48 CFR 9903.202) to major educational institutions (see Sections C.14, K.2.b and Appendix B). Guidance for the implementation and administration of the CAS requirements and the submission of required DS-2s is also provided.

2. Replace the term "indirect" costs with "facilities and administrative" (F&A) costs. F&A costs are synonymous with "indirect" costs, as previously used in this Circular and as currently used in Appendices A and B.

3. Eliminate the use of special cost studies to allocate utility, library and student services costs effective July 1, 1998, at which time an alternative methodology making payments on utility costs will be in place (see Section E.2.d(5)).

4. Require Federal funding agencies to use F&A rates in effect at the time of an initial award throughout the life of the sponsored agreement (see Section G.7).

5. Rescind Circular A-88 and establish cost negotiation cognizance for educational institutions and cognizant agency responsibilities in Circular A-21 (see Section G.11).

6. Eliminate the allowability of dependent tuition benefits (see Section J.8.f(2)).

7. Clarify the policy governing the transition from use allowance to depreciation (see Section J.12.b.(3)).

8. Amend the definition of equipment by increasing the capitalization threshold to the lesser of the amount used for financial statement purposes or \$5000 (see Section J.16).

9. Establish criteria for reimbursement of interest costs (see Section J.22.f).

Circular A-21, as amended by this revision, consists of the Circular published at 44 FR 12368 (2/26/79), as amended by Transmittal Memoranda Numbers 1 through 5, at 47 FR 33658 (7/23/82), 51 FR 20908 (6/9/86), 51 FR 43487 (12/2/86), 56 FR 50224 (10/01/91), 58 FR 39996 (7/15/93), respectively, and the amendments herein. A recompilation of the entire Circular A-21 with all its amendments to date appears at the end of this notice and is available in electronic form on the

OMB Home Page at /OMB, or in hard copy by calling OMB's Publication Office at (202) 395-7332.

#### **D. Paperwork Reduction Act**

This revision includes an information collection requirement for educational institutions receiving more than \$25 million in federally-sponsored agreements to file the CASB's DS-2. This revision's information collection requirement covers more educational institutions than those subject to CASB's regulatory requirement for filing the DS-2, pursuant to Public Law 100-679, which was previously approved and assigned OMB control number 0348-0055 (which expires August 31, 1997). On February 6, 1995 (60 FR 7104), OMB requested comments on this proposed information collection requirement in accordance with the Paperwork Reduction Act (44 U.S.C. Chapter 35 et seq.). The proposed information requirement will not be effective until another notice is published in the Federal Register. The subsequent notice will provide the effective date and the OMB control number.

#### **E. Comments and Responses**

OMB received about 200 comments from colleges and universities, Federal agencies, professional organizations, and accounting firms. The comments and OMB's responses are included in this notice. Several of the comments resulted in modifications to OMB's original proposal.

The comments received and OMB's responses are summarized below.

#### **Cost Accounting Standards (CAS) (Sections C.10-13 & Appendix A)**

**Comment:** Many commenters stated that OMB Circular A-21 currently provides adequate rules and guidelines regarding cost reimbursements for Federal grants and contracts. Therefore, they argued that the proposed incorporation of the CAS would duplicate Circular A-21's requirements.

**Response:** OMB concurs that many of the requirements covered under the CAS currently exist in OMB Circular A-21. However, the four CAS are being incorporated since they provide more explicit provisions and guidance regarding

the consistent application of cost accounting practices at educational institutions. To minimize potential conflict between OMB policies and the Cost Accounting Standards Board (CASB) regulations at 48 CFR 9903, the CASB has committed to perform an analysis to identify administrative requirements -- especially those relating to contract clauses, definitions of a cost accounting practice, and the cost impact process -- that may not be readily adaptable to colleges and universities. The CASB will separately evaluate the need to establish any unique or alternative provisions that should be applied to colleges and universities based on the changes in Circular A-21. Recognizing that the two sets of documents should be compatible, the CASB will, within the limitations imposed by the statutory requirements of the CASB's organic statute, examine the administrative requirements issue in order to determine what improvements can be made to the administrative requirements of the CASB's rules as they effect colleges, universities and Federal cognizant agencies.

**Comment:** The CAS language refers to contracts. Language in the Circular needs to be amended to cover sponsored agreements.

**Response:** The CAS language in Sections C.10, 11, 12 and 13 and Appendix A of the Circular has been changed to cover all forms of sponsored agreements.

**Comment:** The proposal stated that the CAS provisions will not go into effect on January 9, 1995; however, no other effective date was provided. When will the CAS language become effective?

**Response:** For CAS-covered contracts, the CASB's effective date for the application of CAS was January 9, 1995. For other sponsored agreements, the application of CAS is effective for the educational institution's fiscal year starting on or after the publication date of this revision.

**Comment:** The CAS were intended for commercial enterprises and are not appropriate for colleges and universities. Also, commercial enterprises are not limited by a 26 percent administrative cap; therefore, they can recover additional administrative costs to comply with CAS.

**Response:** Commercial contractors are subject to 19 CAS. Only four of those CAS are being applied to universities. The four CAS are for: (1) consistency in estimating, accumulating and reporting costs; (2) consistency in allocating costs incurred for the same purpose; (3) accounting for unallowable costs; and, (4) cost accounting period. Since these CAS merely strengthen the cost principles currently in Circular A-21, the implementation of CAS should not significantly increase burden or result in any additional costs to universities.

**Comment:** The revision limits an educational institution's flexibility to take necessary or advantageous action in a changing environment.

**Response:** The application of the four CAS should not limit an educational institution's flexibility in a changing business environment. The standards only require that costs be treated consistently and, if an educational institution makes an accounting change that materially impacts sponsored agreement reimbursement, then the change and its impact need to be reported. These requirements currently exist in Circular A-21. A change that converts a cost from direct to F&A (during a period where an educational institution has a predetermined F&A rate) normally is not considered a significant change, because it does not have a material impact on sponsored agreement reimbursement.

**Comment:** Limit CAS coverage to sponsored agreements in excess of \$500,000, which is consistent with CAS coverage of contracts. Some universities have several thousand agreements. Most of them are smaller than the \$500,000 threshold. The smaller agreements should not be covered by these requirements. To cover smaller agreements would hold educational institutions to a higher standard than the industry's standard. At issue is whether or not a cost impact proposal or some other form of submission for an equitable adjustment should be made on all agreements.

**Response:** The four CAS promote consistency in cost accounting practices used by an educational institution to estimate, accumulate and report costs charged against federally-sponsored agreements. These underlining principles currently exist in Circular A-21 which covers all sponsored agreements. The four CAS set forth more explicit fundamental requirements, techniques and illustrations on

how to comply with these principles. Therefore, it is appropriate to extend these CAS to all sponsored agreements.

Furthermore, a cost impact proposal is not required to be prepared for each agreement when an educational institution changes accounting practices. Instead, CAS regulations (48 CFR 9903.306 (e) and (f)) allow the use of "any other suitable technique" for cost impact adjustment. Thus, a cost impact adjustment could be done through the F&A cost negotiation process and rate agreement if deemed appropriate by the cognizant agency.

**Comment:** Educational institutions do not have sufficient funds to build accounting systems effective enough to comply with CAS. Commenters suggested an increase of the administrative cap of 26 percent of modified total direct costs (MTDC) to cover the increased paperwork burden. Failing this, the commenters requested an increase of the alternative administrative threshold rate from 24 percent, as allowed in Section G.8, to 26 percent.

**Response:** Compliance with CAS should not require educational institutions to acquire additional accounting systems. Since the CAS only clarify existing provisions for sponsored agreements, existing accounting systems that comply with § 201.21, Standards for financial management systems, in OMB Circular A-110, "Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals and Non-Profit Organizations," should require no change.

**Comment:** The Circular should stipulate that Federal agencies retain the latitude to permit certain administrative expenditures to be charged directly to a project when they believe that these costs are essential for the conduct of the project.

**Response:** Section C.11 states that "all costs incurred for the same purpose, in like circumstances, are either direct costs only or F&A costs only with respect to final costs objectives." However, there are circumstances where it is appropriate to direct charge costs, such as administrative and clerical salaries, when these costs are normally charged indirectly. For example, direct charging of these costs may be appropriate where a major project or activity requires a significant level of

administrative or clerical services and individuals involved can be specifically identified with the project or activity. In this example, the administrative or clerical service costs are not incurred for the same purpose and under like circumstances as are administrative and clerical service costs associated with general university functions, such as accounting operations or general administrative activities, which do not result from specifically identifiable requirements.

**Comment:** CAS definitions (for direct cost, "indirect" cost, consistency and accounting change) are more limiting than in Circular A-21. How will such inconsistencies between the two documents be handled?

**Response:** Inconsistency in definitions and cost policy interpretations do not exist between the two documents. To further assure consistency between the two documents, all inquiries related to the CAS applicable to educational institutions will be addressed by OMB's Office of Federal Financial Management, in coordination with the CASB.

**Comment:** The precision required by CAS would not be consistent with future proposed systems of benchmarking, thresholds, caps, and other limiting factors. OMB is sending out mixed messages.

**Response:** The purposes of the four CAS and future proposed revisions to Circular A-21 are different. The four CAS incorporated in the Circular serve to promote consistent treatment of estimated costs proposed to the Federal Government and actual costs charged as reimbursable cost against federally-sponsored agreements. The purposes of the future proposed revisions are to assure the consistent treatment of costs proposed and charged to federally-sponsored agreements.

**Comment:** Some small colleges have training grants with 8 percent overhead limits. Could CAS requirements and disclosures be waived for those educational institutions with low overhead rates (perhaps 10 percent)?

**Response:** Small colleges with less than \$25 million in Federal funding covered under this Circular will be subject to the CAS but are exempt from the Disclosure Statement filing requirements.



## **Disclosure Statement (DS-2) (Section C.14 & Appendix B)**

**Comment:** Many commenters express concerns that the preparation of the Disclosure Statement (DS-2) can take as much as 2500 hours. A suggestion was made to require a submission only for the year when the educational institution is required to submit a F&A cost rate proposal.

**Response:** OMB disagrees that the DS-2 can take as much as 2500 hours to complete unless a university does not currently have adequate written cost accounting policies. The DS-2 is a 20-page document that provides a summary of an educational institution's cost accounting system for Federal grants and contracts. The cost accounting practices used for Federal grants and contracts should already be properly documented as required by Subpart C, § 101.21, Standards for financial management systems, in OMB Circular A-110. Therefore, the effort to summarize the existing practices in the DS-2 should not be overly burdensome to complete.

In addition, educational institutions do not have to file the DS-2 on an annual basis. Educational institutions are only required to file an initial DS-2 in accordance with the time frame described in Section C.14 and thereafter, educational institutions only need to submit amendments of sections affected by changes in cost accounting practices deemed significant by the cognizant agency. Section C.14.d discourages the resubmission of a complete, updated DS-2 except for extensive changes.

Furthermore, the DS-2 submission is required only for educational institutions receiving more than \$25 million in federally-sponsored agreements during their most recently completed fiscal year.

**Comment:** The paperwork burden imposed has not proven necessary and the costs of providing the information outweigh the benefits to be derived.

**Response:** OMB believes that the DS-2 requires no more information than would normally be provided to the cognizant agency for review of an educational institution's F&A cost rate proposal and for negotiation of the associated rate agreement. OMB does not intend for the paperwork to be an arduous process, rather a reasonable representation of the accounting practices and policies that are used by the educational institution in recovering costs under Federal sponsored programs.

**Comment:** The DS-2 will result in additional work and expense, but, because of the 26 percent cap, educational institutions will not be allowed to recover those amounts.

**Response:** OMB believes that the information required by the DS-2 is of the type that historically should have been submitted during F&A cost rate negotiations and made available for audits of grants and contracts in accordance OMB Circular A-133, "Audits of Institutions of Higher Education and Other Non-Profit Institutions." Therefore, the only additional time requirements should be to put the same information in the format required by the DS-2 and to submit information on accounting changes, as needed. Subsequently, the information will not have to be resubmitted every time a rate proposal is submitted. Only changes in cost accounting practices need to be addressed as the changes are made. This should result in administrative cost savings in the long term.

**Comment:** The revision should clarify what constitutes an accounting change, and provide a materiality threshold so that insignificant changes do not have to be reported.

**Response:** OMB does not intend for educational institutions to report insignificant accounting changes. Sections C.14.d and g emphasize that a change is to be reported and approved by the cognizant agency only when "the change is expected to have a material impact on the educational institution's negotiated F&A rates ..." (emphasis added). The determination of whether an accounting change is significant and, therefore, requires an amendment to the DS-2 and possibly a cost impact proposal is to be made by the cognizant agency. However, educational institutions are prohibited under the allocability clauses of the

Circular from double-counting any costs to the Federal Government which could result from a change in accounting.

**Comment:** There were many comments about confusion over the submission dates for the initial DS-2 between the proposed dates stated in the proposed revision to Circular A-21 and the dates published by the CASB on November 8, 1994.

**Response:** In order to clarify the submission dates for the initial DS-2, and to prevent confusion, the DS-2 submission dates in this Circular for CAS-covered educational institutions are the same as those published by the CASB on November 8, 1994. The DS-2 submission date for educational institution not covered by the CASB requirements is six months after the end of the fiscal year which starts after the publication date of this revision. In addition, the cognizant agency has the authority to provide a filing date extension on a case-by-case basis, unless the DS-2 submission date is defined by receipt of a CAS-covered contract by the educational institution.

**Comment:** Small colleges and universities are disproportionately affected by the DS-2 submission requirements since a small university which received a CAS-covered contract and \$25 million in sponsored awards could have the same submission due date as the top 20 universities which receive substantially more Federal awards (approximately \$150 million or more).

**Response:** To provide consistency and avoid confusion among all colleges and universities regarding the submission due dates for the DS-2, OMB has revised the due dates to correspond with the due dates published by the CASB. A cognizant agency has the authority to grant a filing date extension.

**Comment:** A definition is needed for "a component unit" or the previously-defined terms "segment" and "a business unit" should be used.

**Response:** "A component unit" in Section C.14 is replaced with "a business unit." A business unit at colleges and universities means any unit of an educational institution which is not divided into segments. Segment means one of two or more divisions, campus locations, or other subdivisions of an educational

institution that operate as independent organizational entities under the auspices of the parent educational institution and report directly to an intermediary group office or the governing central system office of the parent educational institution.

**Comment:** For those educational institutions that are required to file a DS-2, there should be a transition time period (e.g., within one year after submittal) in which the cognizant agency is required to identify any procedures or descriptions that it believes would lead to disallowance of costs in the future and the educational institution should be given an opportunity to correct these procedures or descriptions without a penalty. When the document is found acceptable to the cognizant agency, then it should receive a written acknowledgment that, in the agency's opinion, the document describes acceptable practices. An educational institution would then only be subject to disallowances if it is found to be violating its described practices in such a way that unallowable costs were being incurred.

**Response:** OMB disagrees. The DS-2 should disclose the cost accounting practices used to estimate, accumulate and report the costs of sponsored agreements over the award periods of performance. If the cognizant agency identifies established or disclosed cost accounting practices that would lead to disallowance of costs, it would require the educational institution to correct the practice and may also compute a cost adjustment, if material, in accordance with Section C.14.e.

**Comment:** Any subsequent cost adjustments for procedures that are inconsistent with those disclosed in the DS-2 and result in unallowable costs should be limited to the time period beginning after acceptance of the DS-2 by the cognizant agency.

**Response:** While the purpose of the DS-2 is to disclose an educational institution's current cost accounting practices and is intended more for future purposes than for a review of past practices, it may be necessary to make adjustments for some unallowable costs that may have been reimbursed in the past. These adjustments will be made at the discretion of the cognizant agency. Adjustments for the effects of deviations from the practices disclosed in the DS-2 can occur only after the filing. However, the effect of deviations by an educational institution from

established practices, whether or not a DS-2 submission is required, will continue to be subject to adjustments in accordance with Section C.8.

**Comment:** In resolving questions about costs incurred, any claimed disallowances should be based on requirements of Circular A-21 with regards to allowability of costs and not some procedural issue related to following a procedure described in the DS-2.

**Response:** OMB agrees that Circular A-21 should provide the basis of allowability of costs. However, in some instances, the DS-2 will help to clarify how such costs are allocated and may effect the reimbursement of costs claimed as allocable and, therefore, reimbursable costs.

**Comment:** The DS-2 will be difficult to manage when the reporting entity manages grants from various locations. OMB should clarify disclosure requirements for multi-campus and multi-location educational institutions.

**Response:** OMB expects that educational institutions' accounting policies would be the same, particularly if the locations are all covered by the same cost pools. If this is not the case, OMB believes that preparation of the DS-2 will help educational institutions to develop consistent accounting policies. However, if for some justified reasons various locations maintain different cost accounting practices, a separate DS-2 should be submitted for each business unit as stated in Section C.14.a.

### **Terminology ("Indirect" costs)**

**Comment:** Most commenters agreed with the proposed change of terminology from "indirect" costs to "facilities and administrative" costs. However, some commenters noted that this change will create confusion and conflicts with other OMB cost principles circulars and OMB grants management circulars that still use the term "indirect" costs.

**Response:** OMB agrees that inconsistent terminology may cause short term problems. However, this change is needed to more accurately describe the several cost pools for sponsored agreements at educational institutions. The

replacement of the term "indirect" costs will be limited to Circular A-21 and not extended to other OMB grants management circulars because of the several cost pools that exist only in Circular A-21. The term "indirect" costs still appears in Appendix A - CASB's Cost Accounting Standards and Appendix B -Disclosure Statement (DS-2) since these appendices are directly from the CASB's regulations.

### **Special cost studies (Section E.2.d.)**

**Comment:** The provision to limit special cost studies to allocate utility, library and student costs should be delayed until reasonable benchmarks can be established for the payment of these costs.

**Response:** Benchmark studies to develop alternative payment methods for facility construction, utilities and library costs are currently underway. In the meantime, due to the ambiguous nature of special cost studies that were the source of disagreement between cognizant agencies and institutions, OMB plans to make utility, library and student services cost recoveries based on special cost studies unallowable costs. This restriction's effective date is delayed until July 1, 1998 at which time OMB will have in place an alternative method to pay utility costs. Utility, library and student services cost allocations based on special cost studies will be disallowed for administrative and facilities payment rates negotiated on or after July 1, 1998. The special cost studies cannot be used to establish rates beyond fiscal year ending in 1998, unless a rate agreement in effect at the time of this publication extends beyond 1998, in which case the use of special cost studies will terminate at the end of the rate agreement period. OMB is currently reviewing proposals for alternative methodologies for making payments on costs related to utilities. OMB will publish the proposals for public comments prior to July 1, 1997.

**Comment:** Instead of eliminating the special cost studies, OMB should develop standards, methodology and criteria for conducting special cost studies that would be acceptable for the Federal Government.

**Response:** Special cost studies were cited as an example of an area of potential abuse and source of disagreement and distrust between cognizant agencies and

institutions. Rather than try to devise a set of complex parameters that would preclude any opportunity for abuse, OMB decided to disallow any cost allocations based upon those studies and, instead, to provide an alternative payment mechanism.

### **Fixed Rates (Section G.7)**

**Comment:** Clarification of "life of agreement" is needed since a project can extend over a long period of time exceeding ten or fifteen years at times. Does it mean each continuing period of an award or each competing renewal of an award? Fixed rates should only apply prospectively to new awards. "Life" should mean each competitive renewal period. A commenter suggested that a fixed rate apply for a period of three years.

**Response:** OMB has clarified "life of agreement" to mean each new competitive segment. A competitive segment is a period of years approved for a project at the time of the award, usually three to five years. Fixed rates will apply only to awards made after the publication date of this revision.

**Comment:** A clarification is needed for the impact of a fixed rate throughout the life of the award on the various types of rates, i.e., provisional, predetermined and fixed rates.

**Response:** The revision requires that the Federal funding agencies use rates in effect at time of award throughout the life of the award, using the negotiated rates (predetermined, fixed or provisional) at the time of the award. For example, if an educational institution has a provisional rate of 40 percent at the time of the award, the 40 percent rate will be used for funding and reimbursement throughout the life of that award. If an educational institution has predetermined rates of 40 percent (first year), 42 percent (second year) and 45 percent (third year), then a five-year project would have rates of 40 percent (first year), 42 percent (second year) and 45 percent (third, fourth and fifth years).

When an educational institution does not have a negotiated rate with the Federal Government at the time of the award (because the educational institution is a new grantee or the parties cannot reach agreement on a rate), the provisional

rate used at the time of the award will be adjusted after a rate is negotiated and approved by the cognizant agency.

**Comment:** To implement a fixed rate throughout the life of an award penalizes a university with growth in facility costs. This would discourage colleges and universities from investing in facility costs.

**Response:** When entering into an agreement with educational institutions to perform a specific project, it is only fair for the Federal Government to commit funding and reimbursement based on the conditions as they are understood to exist at that time. Most research project activities remain in the same laboratory during the entire life of the project and, therefore, the facility costs should remain at the same level. A fixed rate throughout the life of an award would only adversely affect an educational institution when, after the award date, the educational institution moved the project into a more modern and expensive facility. Therefore, for future awards, an educational institution with growth in facility costs should seek to establish future cost rates (fixed or predetermined) that reflect the growing cost pattern.

**Comment:** It is not clear what rate is to be used when the educational institution's rate is decreasing during the life of the award.

**Response:** In the case of anticipated declining cost rates, the educational institution should provide the basis for the anticipated decline. Total funding for the award would reflect the anticipated decline. If a declining cost rate is not anticipated at the time of award, the educational institution may recover the costs at the rates in effect at the time of the award.

**Comment:** Fixed rates should not be applied to primate centers that are funded by the National Institutes of Health P-51 awards, since these centers are involved in a very long-term agreement with the Federal Government for specific research activities.

**Response:** The fixed rates concept does not apply to the seven primate animal care facilities that are involved in special animal research funded under the National Institutes of Health P-51 - Primate Research Center Grant. These centers



are primarily federally-funded and are involved in a very long-term agreement with the Federal Government. The federally-funded F&A costs that make up the rates are used to charge the educational institution's users of the facility and are treated as program income and returned to the Federal awards.

**Comment:** Fixed rates should only be used for funding a total project, regardless of Federal reimbursement of a university's F&A costs. This policy is consistent with the funding and reimbursement policies for grants by the National Science Foundation (NSF).

**Response:** Current NSF policies award a fixed amount (direct and F&A costs) for the conduct of an entire project. This policy allows the educational institution to recover more F&A costs than originally budgeted as long as the total reimbursement for the project does not exceed the funding for the total award. The revision in Section G.7 provides that a fixed rate shall be used for both funding and reimbursement of F&A costs during an award's life (or a competitive segment's life). This policy assures that the Federal Government is receiving the level of services (i.e., research) agreed to by the educational institution and the Federal agency when the award was made. If the fixed rate concept is used only for funding of the award and not reimbursement of F&A costs, during periods of increasing rates, while the total funding for the award remains the same, then a shift of funding available for direct costs to F&A costs would occur. Therefore, the funding available for direct cost activities would decrease and so would the level of services (or research).

### **Cost Negotiation Cognizance (Section G.11)**

**Comment:** The Circular should address the effects that a change in cost negotiation cognizance would have on an educational institution's administrative functions.

**Response:** A change in cost negotiation cognizance should have no impact on an educational institution's administrative functions. The consolidation of cognizant agencies for cost negotiation will enhance the consistency in the application and

interpretations of the Circular's cost principles and in the review of cost rate proposals.

**Comment:** Several commenters suggest that the period for cognizant agency assignment should be ten years rather than five since universities frequently negotiate multiple year rates for two or three years.

**Response:** The assignment period for a cognizant agency will remain at five years, as proposed. A five-year period assignment should normally extend over more than two normal negotiation cycles. Furthermore, since the funding pattern from particular Federal agencies at a particular university usually does not change over a short time period, the cognizance should remain reasonably stable.

**Comment:** One commenter suggests that financial statements rather National Science Foundation (NSF) data should be used in the determination of a cognizant agency.

**Response:** The preferable source for cognizant agency determination would be the Schedule of Federal Awards, as required by OMB Circular A-133, that accompanies an educational institution's financial statements. However, information on the Schedules of Federal Awards has not yet been automated in a Federal data base. Therefore, the best source data are the most recent three years of data published by NSF in its annual report ("Selected Data on Federal Support to Universities and Colleges"), in the table at page 5, entitled "Federal obligations for science and engineering research and development to universities and colleges, ranked by total amount received, by agency; fiscal year." OMB is revising Circular A-133 which will establish a data base that can be used for this purpose.

**Comment:** Which would be the cognizant agency for educational institutions that do not receive either HHS or the Department of Defense, Office of Naval Research (DOD) funding? One commenter suggested that an agency which has a predominant interest and an on-site presence should be the cognizant agency. The concern is that the major funding agency may not have the authority to address cost issues that impact its funded projects.

**Response:** The Circular has been revised to provide that an educational institution will have an assigned cognizant agency even when HHS or DOD provides little or no funding at that educational institution. Cognizance is assigned to either HHS or DOD depending on which of the two agencies (HHS or DOD) provides more funds to the educational institution. In cases where neither HHS nor DOD provides any funding, the cognizant agency assignment shall default to HHS. Other arrangements for cognizance of a particular educational institution may also be made based on mutual agreement by both HHS and DOD.

Section G.11 also states that the cognizant agency is responsible for coordinating the formal negotiation and arranging a pre-negotiation conference if there is interest from another agency. This process assures that an interested major funding agency is not precluded from participating in the negotiation process.

**Comment:** The agency with Federal audit cognizance (established by Circular A-133) and cost negotiation cognizance (established by Circular A-21) should be the same for each educational institution.

**Response:** With the rescission of OMB A-88, which assigned a single Federal cognizant agency for rate negotiation, audit and audit follow-up, an educational institution may have two different agencies responsible for audit and cost cognizance. OMB believes that the audit function and cost negotiation functions are different functions. This division of responsibility works effectively for State and local governments under Circulars A-87, "Cost Principles for State, Local and Indian Tribal Governments" (60 FR 26484; May 17, 1995), and A-128, "Audits of State and Local Governments" (50 FR 19114; May 10, 1985).

**Comment:** Which agency would be the cognizant cost negotiation agency for the Federally-Funded Research and Development Centers (FFRDCs) associated with educational institutions? Is the FFRDC included in the total dollar amount received by the educational institution for the determination of a cognizant agency?

**Response:** Federal responsibilities associated with FFRDCs are not affected by the revision to Circular A-21. FFRDCs associated with educational institutions are independent organizations that function outside the operational activities of the

educational institutions. They are required to comply with the CAS and rules and regulations issued by the CASB set forth in 48 CFR Chapter 99. The determination of their cognizant agency will continue to be based on the primary funding source. Federal funding to FFRDCs shall be excluded from the determination of cost cognizance for an educational institution.

**Comment:** Several commenters suggested that Federal agencies do not have the authority to use a F&A rate for a class of sponsored agreements or a single agreement other than the negotiated rates. To allow this would defeat the purpose of standardized rate agreements.

**Response:** Under normal circumstances, the negotiated rates established between the educational institution and the cognizant agency should be used by all agencies. The Circular has been revised to state that only under special circumstances prescribed by law or regulation can an agency use a rate other than the negotiated rate.

**Comment:** The proposed revision stated that cognizant assignments as of December 31, 1995, will continue in effect through an educational institution's fiscal years ending during 1997. Is this based on the receipt of the educational institution's cost proposal or is it based on the year for which the proposal is prepared?

**Response:** The transfer of cognizance assignment is based on the receipt date of the cost proposal. The cognizant agency for an educational institution as of December 31, 1995, is responsible for the review and negotiation of rates for all cost proposals submitted to that agency through fiscal years ending during 1997. The cognizant agency is also responsible for any disputes or appeals that result from proposals submitted through fiscal years ending during 1997.

### **Dependent Tuition Benefits (Section J.8)**

**Comment:** Most commenters stated that dependent tuition benefits are legitimate fringe benefit costs, as are health benefits, and are commonly used by a university to attract the best faculty and staff. This benefit should not be eliminated. A comparison of this benefit to the private sector should not be made

since the salary for faculty and staff are typically much lower and university employees do not receive some benefits offered by the private sector, such as stock options. Eliminating the dependent tuition benefit will cause universities to raise wages for their employees, thus ultimately resulting in higher costs for Federal research.

**Response:** OMB disagrees for the following reasons:

(1) Some universities charge federally-sponsored agreements for dependent tuition assistance even when there is no actual cost incurred by the university. For example, in the four universities covered by a recent General Accounting Office (GAO) study ("University Research - U.S. Reimbursement of Tuition Costs for University Employee Family Members," GAO/NSIAD-95-19), when a dependent attended the university where an employee worked, the four universities charged tuition in full or in part to federally-sponsored agreements. GAO's report provided an example in which an institution "would have charged \$18,000 to the fringe benefit pool for a child of a tenured faculty member attending the university during 1993." Generally, provision of substantial fringe benefits that do not in fact impose a measurable cost on an entity are not a "cost" that is properly chargeable to the government.

(2) Since 1977, the Federal Acquisition Regulation (FAR)(48 CFR Subpart 31.205-44, "Training and education costs"), which applies to Federal contracts with commercial firms, has treated dependent tuition benefit as an unallowable cost. This change was made because the procurement regulation review committee, which studied changes to the FAR in the mid 1970's, believed that there was no benefit to the government from subsidizing tuition costs of employee family members.

(3) Dependent tuition benefits are unique to educational institutions, i.e., they are not available as a normal business practice for the private sector (subject to the FAR), State and local governments (subject to OMB Circular A-87), and non-profit organizations (subject to OMB Circular A-122, "Cost Principles for Non-Profit Organizations"). Allowing dependent tuition benefits to educational institutions would provide allowable costs for only one group of grantees and contractors.

(4) No evidence has been offered to support the comment that compensation for educational institution faculty and staff currently is much lower than compensation in the private sector for the same discipline. If higher salary levels are required to attract faculty and staff, then such salaries will be chargeable to Federal awards to the extent allowable under this Circular and the terms of the awards.

Based on the above reasons, the Circular is revised to disallow dependent tuition benefits for educational institutions' fiscal years starting on or after September 30, 1998.

**Comment:** A phase-in period with an effective date of 1998 should be allowed for the total elimination of this benefit.

**Response:** Given existing contractual commitments to faculty and staff, the effective date for making the dependent tuition an unallowable cost is the educational institution's fiscal years beginning on or after September 30, 1998.

#### **Use Allowance/Depreciation (Section J.12)**

**Comment:** The educational institution should be allowed to depreciate the remaining (full) value of the assets at the time of conversion, using the depreciation rate until the assets are disposed.

**Response:** For claiming its costs on a single class of assets, an educational institution always has the choice of selecting either the use allowance or depreciation methodology. These two methodologies are based on different cost reimbursement principles (i.e., use allowance allows cost recovery beyond useful lives as long as the asset is in use, while depreciation allows a quicker cost recovery based on a depreciable life only). The selection of recovery method is up to the educational institution.

Circular A-21 does not require the educational institution to convert from the use allowance method to the depreciation method. The revision in Section J.12.b.(3) simply clarifies that, in the case where an educational institution, by its own choice, elects to convert from use allowance to the depreciation method, the

conversion should be made as if the depreciation method had been used over the entire life of the asset.

Additionally, the "allocability principle" in Section C.4 of Circular A-21 states that "a cost is allocable to a particular cost objective if the goods or services involved are chargeable or assignable to such cost objective in accordance with relative benefits received or other equitable relationship" (emphasis added). 44 FR 12368 (February 26, 1979). The allocability principle would be violated if unclaimed costs could be charged to the future periods that do not benefit from the use of the asset.

**Comment:** Circular A-21 should allow the use allowance method for old buildings and the depreciation method for new buildings rather than restrict the use of one method of reimbursement for one type of assets. The provision should apply to new assets only and not all assets. The commenter recommends changing the language to "a combination of the depreciation and use allowances may not be used for new assets."

**Response:** Section J.12.d has provided that a combination of the depreciation and use allowance may not be used, in like circumstances, for a single class of assets. To allow the use of both methods for a single class of assets would violate the consistent treatment principle of the Circular, complicate the depreciation/use allowance calculation process, and create inequities in the recovery of asset costs against Federal programs. This provision prevents an educational institution from both using depreciation to recover the cost of assets with useful lives that are shorter than the average lives reflected in the use allowance rates (50 years for buildings and 15 years for equipment) AND using allowance for the recovery of assets with longer useful lives. The mix of the two methods for a single class of assets is clearly inequitable to the Federal Government since the use allowance method is a simplified recovery method that is based on an averaging concept which implicitly recognizes that certain assets within each broad category have lives that differ from the average. OMB does not see the need to change this policy since it is the educational institution's choice to select the appropriate method of recovery for facility costs.

**Comment:** The provision should allow full recovery of assets that are converted from use allowance to depreciation. This could be done by allowing use allowance beyond the asset's depreciable "life" -- as long as the assets are in use -- until the full cost is recovered. Authorization from the cognizant agency shall be obtained.

**Response:** OMB disagrees. If the depreciation method is used, Section J.12.b.(5) provides that depreciation is not allowed on any assets that have outlived their depreciable lives. However, Section J.12.c.(3) allows a "reasonable use allowance" for any assets that are considered to be fully depreciated after considering 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 purposed contemplated. The allowable amounts are determined by the cognizant agency. This provision allows a use allowance for fully depreciated assets only under the most extraordinary circumstances and is not applicable when converting from use allowance to depreciation. This provision is intended to permit reimbursement under unusual circumstances where an asset is treated as having outlived its useful life but nevertheless has future cost consequences that are not recoverable through capitalized repair and replacement costs or as current period expenses.

An example of a "reasonable use allowance" is for the use of an electronic microscope by the educational institution after its useful life. At the start of its service life, a reasonable estimate of the useful life of an electronic microscope is five years. However, after five years, when the asset is fully depreciated and its costs fully recovered, if it is still functional and is used to support Federal projects, then consideration may be given by the cognizant agency for a reasonable use allowance. This approach results in cost savings both for the educational institution and the Federal Government since the educational institution could have replaced the old electronic microscope with a new, more expensive one and then appropriately charge a use allowance to the Federal projects.

#### **Equipment Definition (Section J.16)**



**Comment:** The effective date of the equipment definition change should be prior to the expiration of an educational institution's F&A cost rate agreements.

**Response:** In order to simplify the transition, the effective date of the equipment definition change will be at the beginning of the next F&A cost rate agreement. An educational institution with predetermined or fixed rates that wishes to raise its equipment threshold earlier should contact its cognizant agency for approval. While educational institutions are free to change their capitalization policy at any time, there should be limitations as to when sponsoring agencies may recognize the change. To do otherwise could result in direct costs and F&A costs being reimbursed under conditions different from those upon which the F&A cost rate was predicated. Federal sponsoring agencies are to award, and grantees are to claim, costs in accordance with the policies in effect at the time the cost rate agreement was issued. At the cognizant agency's discretion, revised cost rates may be established based on an analysis of the impact on cost rates of the conversion.

**Comment:** Clarification is needed on the treatment of depreciation of those assets which had costs between the old \$500 threshold and the new \$5000.

**Response:** In order to clarify the accounting for the unamortized portion of any equipment costs as a result of a change in capitalization levels, language has been added to Section J.16.a.(1) to explain that the unamortized portion may be recovered by continuing to claim the otherwise allowable use allowance or depreciation on the equipment, or by amortizing the amount to be written off over a period of years negotiated with the cognizant agency.

## **Interest Criteria (Section J.22)**

### **General**

**Comment:** Clarifications are needed for the calculations used in the lease-purchase analysis and the cash-flow analysis.

**Response:** The commenter is correct. The Circular has been revised to provide the following clarifications for the interest requirements. A threshold of \$500,000 has

been set for the requirement of a lease-purchase analysis for a facility acquisition, a cash-flow analysis is required for debt arrangements over \$1 million (when the initial equity contribution by the educational institution is less than 25 percent), and notification is required in case of a substantial relocation from a building funded in part or whole through Federal reimbursements. The same clarifications adopted in the final revision of the interest provision of Circular A-122 (60 FR 52516), have been included in this revision to Circular A-21 in Section J.22.f. This will maintain conformity across the cost principles circulars.

**Comment:** The requirements under the interest criteria create an additional administrative burden for colleges and universities in a period when the administrative costs are already capped.

**Response:** OMB recognizes that there might be a nominal increase in an administrative burden in a few cases. However, OMB believes that these requirements are needed to protect the Federal Government against abusive financing arrangements (such as "balloon financing method" where the entire principal amount is made at the end of the finance term).

**Comment:** The requirements should only apply prospectively to future asset acquisitions.

**Response:** OMB revises the provision in Section J.22.f to state that the criteria for interest allowability in this revision apply only to facilities and equipment acquired after the effective date of this revision.

**Comment:** What are the reimbursement limitations when the least expensive alternative is not chosen?

**Response:** As the revision in Section J.22.f states, when a lease-purchase analysis is required to be performed, reimbursement will be limited to the least expensive alternative available, whether or not it is the chosen alternative.

**Comment:** Where a facility is acquired and the components are depreciated over varying lives, can interest on debt associated with fully depreciated assets be claimed?

**Response:** No. Under the allocability provisions of Section C.4.a, interest costs on fully depreciated, retired, scrapped, or nonexistent assets are unallowable.

**Comment:** Where a new facility is acquired or constructed with excess capacity intended to meet future needs, can interest costs be claimed for that portion of the facility that is currently excess and not in use?

**Response:** No. Under the allocability provisions of Section C.4.a, interest costs on excess or idle capacity are not allocable to Federal programs and are, therefore, unallowable. This provision also applies to any related costs, such as depreciation.

### **Lease-Purchase Analysis**

**Comment:** A higher threshold should be established for the requirement of the lease-purchase analysis. Thresholds of \$50 million and \$25 million were recommended.

**Response:** Many commenters indicated that lease-purchase analyses are generally performed by the educational institutions as a common business practice. Such analyses normally are performed for assets under the suggested \$25 million threshold, whether or not Federal funds are involved. The expense of the analysis is justified when one considers the considerably greater amounts that are at stake in a real estate lease or purchase. Also, by identifying the most economical acquisition alternative, such analyses can pay for themselves. Section C.3 of Circular A-21 requires that, to be allowable, costs must be reasonable. A lease-purchase analysis provides such supporting documentation. A threshold of \$25 million or \$50 million is simply too high to protect the interests of the Federal Government

However, OMB recognizes that a lease-purchase analysis may not be cost effective for smaller facility acquisitions. Therefore, a threshold of \$500,000 has been established in the final revision for the lease-purchase analysis requirement for facilities. Additionally, the analysis is not required to be submitted but is only to be maintained on file for cognizant agency review upon request. There is no requirement for a lease-purchase analysis for equipment.

## Cash-Flow Analysis

*(Note: Sample A-21 Excess Cash-Flow Calculation is shown at the end of this document.)*

**Comment:** The educational institution should have the option of rolling forward the "excess" cash recovery to future years rather than being disallowed in the year incurred since interest costs are often based on a declining principal balance and are not spread evenly over the life of the mortgage.

**Response:** The provision on "excess" cash flow addresses the interest costs to the Federal Government in instances where cash flow from depreciation exceeds debt principal payments (e.g., a "balloon" payment arrangement). In such case, where the entire principal amount is paid at the end of the finance period, the cash flow received by the educational institution for reimbursement of depreciation and interest expenses on a facility would exceed the payments made by the educational institution for interest and principal, thus resulting in an excessive cash flow. The interest on the excess cash flow should be deducted from interest costs in the year earned and not spread out over the life of the mortgage since the Federal Government pays its proportionate share of future period interest.

The provision requiring an adjustment to allowable interest for positive cash flow does not result in a "disallowance" of depreciation exceeding principal payments. When inflows exceed outflows, earnings are to be imputed on the excess cash flow and offset against interest costs for the 12-month period. The educational institution, however, retains the excess cash flow which will be needed during periods of negative cash flow.

A sample cash-flow analysis is presented hereafter.

**Comment:** The provision requires that earnings on positive cash flows be offset against interest costs. If principal payments include the cost of land, the positive cash flow and imputed earnings will be understated.

**Response:** OMB agrees. While interest on debt to acquire land is allowable, the cost of land is not. Accordingly, when computing cash flows, each debt principal payment shall be reduced by an amount equal to the portion of the principal payment attributed to the acquisition of land. This requirement is included in Section J.22.f.

## **CASH-FLOW ANALYSIS**

### **Interagency Policy Group**

**Comment:** The establishment of a Federal interagency group for the development of grant and contract policy should be addressed in Circular A-110 rather than Circular A-21. This group should include representatives from colleges and universities.

**Response:** The commenter is correct that the interagency policy group should be formed under broader auspices than just Circular A-21. In response, the proposal has been deleted from the final revision of this Circular. This proposal is not being pursued at this time.

Alice M. Rivlin  
Director

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April 26, 1996

Circular No. A-21

Revised

Transmittal Memorandum No. 6

## **TO THE HEADS OF EXECUTIVE DEPARTMENTS AND ESTABLISHMENTS**

**SUBJECT:** Cost Principles for Educational Institutions

This transmittal memorandum revises OMB Circular No. A-21, "Cost Principles for Educational Institutions." The attached revision further clarifies and standardizes the Circular's principles for determining costs applicable to grants, contracts, and

other agreements with educational institutions, and rescinds OMB Circular A-88, "Indirect Cost Rates, Audits, and Audit Follow-up at Educational Institutions." This revision is effective on the date of its publication in the Federal Register, unless otherwise noted within this revision.

Also attached is a recompilation of Circular A-21 that consists of the original Circular published at 44 FR 12368 (February 26, 1979), as amended by Transmittal Memoranda Numbers 1 through 5, at 47 FR 33658 (July 23, 1982), 51 FR 20908 (June 9, 1986), 51 FR 43487 (December 2, 1986), 56 FR 50224 (October 1, 1991), 58 FR 39996 (July 15, 1993), respectively, and the amendments herein.

Alice M. Rivlin  
Director

Attachments

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**I. Circular A-88 is rescinded, effective July 1, 1996.**

**II. Circular A-21 is revised as follows: Revise Sections A, C, G, J and K as follows.**

1. In Section A, add subsection 4 to read as follows: 4. Inquiries. All inquiries from Federal agencies concerning the cost principles contained in this Circular, including the administration and implementation of the Cost Accounting Standards (CAS)(described in Sections C.10 through C.13) and disclosure statement (DS-2) requirements, shall be addressed by the Office of Management and Budget (OMB), Office of Federal Financial Management, in coordination with the Cost Accounting Standard Board (CASB) with respect to inquiries concerning CAS. Educational institutions' inquiries should be addressed to the cognizant agency. 2. In Section C, change subsection 8 as follows.8. Collection of unallowable costs, excess costs due to noncompliance with cost policies, increased costs due to failure to follow a disclosed accounting practice and increased costs resulting from a change in cost accounting practice. The following costs shall be refunded (including interest) in accordance with applicable Federal agency regulations:

- a. Costs specifically identified as unallowable in Section J, either directly or indirectly, and charged to the Federal Government.
- b. Excess costs due to failure by the educational institution to comply with the cost policies in this Circular.
- c. Increased costs due to a noncompliant cost accounting practice used to estimate, accumulate, or report costs.
- d. Increased costs resulting from a change in accounting practice.

3. In Section C, add subsection 10 to read as follows: 10. Consistency in estimating, accumulating and reporting costs.

- a. An educational institution's practices used in estimating costs in pricing a proposal shall be consistent with the educational institution's cost accounting practices used in accumulating and reporting costs.
- b. An educational institution's cost accounting practices used in accumulating and reporting actual costs for a sponsored agreement shall be consistent with the educational institution's practices used in estimating costs in pricing the related proposal or application.
- c. The grouping of homogeneous costs in estimates prepared for proposal purposes shall not per se be deemed an inconsistent application of cost accounting practices under subsection a when such costs are accumulated and reported in greater detail on an actual cost basis during performance of the sponsored agreement.

d. Appendix A also reflects this requirement, along with the purpose, definitions, and techniques for application, all of which are authoritative.

4. In Section C, add subsection 11 to read as follows: 11. Consistency in allocating costs incurred for the same purpose.

- a. All costs incurred for the same purpose, in like circumstances, are either direct costs only or F&A costs only with respect to final cost objectives. No final cost objective shall have allocated to it as a cost any cost, if other costs incurred for

the same purpose, in like circumstances, have been included as a direct cost of that or any other final cost objective. Further, no final cost objective shall have allocated to it as a direct cost any cost, if other costs incurred for the same purpose, in like circumstances, have been included in any F&A cost pool to be allocated to that or any other final cost objective.

b. Appendix A reflects this requirement along with its purpose, definitions, techniques for application, illustrations and interpretations, all of which are authoritative.

5. In Section C, add subsection 12 to read as follows: 12. Accounting for unallowable costs.

a. Costs expressly unallowable or mutually agreed to be unallowable, including costs mutually agreed to be unallowable directly associated costs, shall be identified and excluded from any billing, claim, application, or proposal applicable to a sponsored agreement.

b. Costs which specifically become designated as unallowable as a result of a written decision furnished by a Federal official pursuant to sponsored agreement disputes procedures shall be identified if included in or used in the computation of any billing, claim, or proposal applicable to a sponsored agreement. This identification requirement applies also to any costs incurred for the same purpose under like circumstances as the costs specifically identified as unallowable under either this subsection or subsection a.

c. Costs which, in a Federal official's written decision furnished pursuant to sponsored agreement disputes procedures, are designated as unallowable directly associated costs of unallowable costs covered by either subsection a or b shall be accorded the identification required by subsection b.

d. The costs of any work project not contractually authorized by a sponsored agreement, whether or not related to performance of a proposed or existing sponsored agreement, shall be accounted for, to the extent appropriate, in a manner which permits ready separation from the costs of authorized work projects.



e. All unallowable costs covered by subsections a through d shall be subject to the same cost accounting principles governing cost allocability as allowable costs. In circumstances where these unallowable costs normally would be part of a regular F&A cost allocation base or bases, they shall remain in such base or bases. Where a directly associated cost is part of a category of costs normally included in a F&A cost pool that shall be allocated over a base containing the unallowable cost with which it is associated, such a directly associated cost shall be retained in the F&A cost pool and be allocated through the regular allocation process.

f. Where the total of the allocable and otherwise allowable costs exceeds a limitation-of-cost or ceiling-price provision in a sponsored agreement, full direct and F&A cost allocation shall be made to the sponsored agreement cost objective, in accordance with established cost accounting practices and standards which regularly govern a given entity's allocations to sponsored agreement cost objectives. In any determination of a cost overrun, the amount thereof shall be identified in terms of the excess of allowable costs over the ceiling amount, rather than through specific identification of particular cost items or cost elements.

g. Appendix A reflects this requirement, along with its purpose, definitions, techniques for application, and illustrations of this standard, all of which are authoritative.

6. In Section C, add subsection 13 to read as follows: 13. Cost accounting period.

a. Educational institutions shall use their fiscal year as their cost accounting period, except that:

(1) Costs of a F&A function which exists for only a part of a cost accounting period may be allocated to cost objectives of that same part of the period on the basis of data for that part of the cost accounting period if the cost is: (i) material in amount, (ii) accumulated in a separate F&A cost pool or expense pool, and (iii) allocated on the basis of an appropriate direct measure of the activity or output of the function during that part of the period.

(2) An annual period other than the fiscal year may, upon mutual agreement with the Federal Government, be used as the cost accounting period if the use of such

period is an established practice of the educational institution and is consistently used for managing and controlling revenues and disbursements, and appropriate accruals, deferrals or other adjustments are made with respect to such annual periods.

(3) A transitional cost accounting period other than a year shall be used whenever a change of fiscal year occurs.

b. An educational institution shall follow consistent practices in the selection of the cost accounting period or periods in which any types of expense and any types of adjustment to expense (including prior-period adjustments) are accumulated and allocated.

c. The same cost accounting period shall be used for accumulating costs in a F&A cost pool as for establishing its allocation base, except that the Federal Government and educational institution may agree to use a different period for establishing an allocation base, provided:

(1) The practice is necessary to obtain significant administrative convenience,

(2) The practice is consistently followed by the educational institution,

(3) The annual period used is representative of the activity of the cost accounting period for which the F&A costs to be allocated are accumulated, and

(4) The practice can reasonably be estimated to provide a distribution to cost objectives of the cost accounting period not materially different from that which otherwise would be obtained.

d. Appendix A reflects this requirement, along with its purpose, definitions, techniques for application and illustrations, all of which are authoritative.

7. In Section C, add subsection 14 to read as follows: 14. Disclosure Statement.

a. Educational institutions that received aggregate sponsored agreements totaling \$25 million or more subject to this Circular during their most recently completed fiscal year shall disclose their cost accounting practices by filing a Disclosure Statement (DS-2), which is reproduced in Appendix B. With the approval of the

cognizant agency, an educational institution may meet the DS-2 submission by submitting the DS-2 for each business unit that received \$25 million or more in sponsored agreements.

b. The DS-2 shall be submitted to the cognizant agency with a copy to the educational institution's audit cognizant office.

c. Educational institutions receiving \$25 million or more in sponsored agreements that are not required to file a DS-2 pursuant to 48 CFR 9903.202-1 shall file a DS-2 covering the first fiscal year beginning after the publication date of this revision, within six months after the end of that fiscal year. Extensions beyond the above due date may be granted by the cognizant agency on a case-by-case basis.

d. Educational institutions are responsible for maintaining an accurate DS-2 and complying with disclosed cost accounting practices. Educational institutions must file amendments to the DS-2 when disclosed practices are changed to comply with a new or modified standard, or when practices are changed for other reasons. Amendments of a DS-2 may be submitted at any time. If the change is expected to have a material impact on the educational institution's negotiated F&A cost rates, the revision shall be approved by the cognizant agency before it is implemented. Resubmission of a complete, updated DS-2 is discouraged except when there are extensive changes to disclosed practices.

e. Cost and funding adjustments. Cost adjustments shall be made by the cognizant agency if an educational institution fails to comply with the cost policies in this Circular or fails to consistently follow its established or disclosed cost accounting practices when estimating, accumulating or reporting the costs of sponsored agreements, if aggregate cost impact on sponsored agreements is material. The cost adjustment shall normally be made on an aggregate basis for all affected sponsored agreements through an adjustment of the educational institution's future F&A costs rates or other means considered appropriate by the cognizant agency. Under the terms of CAS-covered contracts, adjustments in the amount of funding provided may also be required when the estimated proposal costs were not determined in accordance with established cost accounting practices.

f. Overpayments. Excess amounts paid in the aggregate by the Federal Government under sponsored agreements due to a noncompliant cost accounting practice used to estimate, accumulate, or report costs shall be credited or refunded, as deemed appropriate by the cognizant agency. Interest applicable to the excess amounts paid in the aggregate during the period of noncompliance shall also be determined and collected in accordance with applicable Federal agency regulations.

g. Compliant cost accounting practice changes. Changes from one compliant cost accounting practice to another compliant practice that are approved by the cognizant agency may require cost adjustments if the change has a material effect on sponsored agreements and the changes are deemed appropriate by the cognizant agency.

h. Responsibilities. The cognizant agency shall:

(1) Determine cost adjustments for all sponsored agreements in the aggregate on behalf of the Federal Government. Actions of the cognizant agency official in making cost adjustment determinations shall be coordinated with all affected Federal agencies to the extent necessary.

(2) Prescribe guidelines and establish internal procedures to promptly determine on behalf of the Federal Government that a DS-2 adequately discloses the educational institution's cost accounting practices and that the disclosed practices are compliant with applicable CAS and the requirements of this Circular.

(3) Distribute to all affected agencies any DS-2 determination of adequacy and/or noncompliance.

8. In Section E, add subsection 2.d(5) to read as follows: 2.d(5) Notwithstanding subsection (3), effective July 1, 1998, a cost analysis study or base other than that in Section F shall not be used to distribute utility, library or student services costs. By that date, OMB shall have in place an alternative methodology for making payments on costs related to utilities. 9. In Section G, add a new subsection 7 to read as follows, and renumber all subsequent subsections from 7, 8 and 9 to 8, 9 and 10, respectively: 7. Fixed rates for the life of the sponsored agreement.

a. Federal agencies shall use the negotiated rates for F&A costs in effect at the time of the initial award throughout the life of the sponsored agreement. "Life" for the purpose of this subsection means each competitive segment of a project. A competitive segment is a period of years approved by the Federal funding agency at the time of the award. If negotiated rate agreements do not extend through the life of the sponsored agreement at the time of the initial award, then the negotiated rate for the last year of the sponsored agreement shall be extended through the end of the life of the sponsored agreement. Award levels for sponsored agreements may not be adjusted in future years as a result of changes in negotiated rates.

b. When an educational institution does not have a negotiated rate with the Federal Government at the time of the award (because the educational institution is a new grantee or the parties cannot reach agreement on a rate), the provisional rate used at the time of the award shall be adjusted once a rate is negotiated and approved by the cognizant agency.

10. In Section G, add subsection 11 to read as follows: 11. Negotiation and approval of F&A rate.

a. Cognizant agency assignments. "A cognizant agency" means the Federal agency responsible for negotiating and approving F&A rates for an educational institution on behalf of all Federal agencies.

(1) Cost negotiation cognizance is assigned to the Department of Health and Human Services (HHS) or the Department of Defense's Office of Naval Research (DOD), normally depending on which of the two agencies (HHS or DOD) provides more funds to the educational institution for the most recent three years. Information on funding shall be derived from relevant data gathered by the National Science Foundation. In cases where neither HHS nor DOD provides Federal funding to an educational institution, the cognizant agency assignment shall default to HHS. Notwithstanding the method for cognizance determination described above, other arrangements for cognizance of a particular educational institution may also be based in part on the types of research performed at the

educational institution and shall be decided based on mutual agreement between HHS and DOD.

(2) Cognizant assignments as of December 31, 1995, shall continue in effect through educational institutions' fiscal years ending during 1997, or the period covered by negotiated agreements in effect on December 31, 1995, whichever is later, except for those educational institutions with cognizant agencies other than HHS or DOD. Cognizance for these educational institutions shall transfer to HHS or DOD at the end of the period covered by the current negotiated rate agreement. After cognizance is established, it shall continue for a five-year period.

b. Acceptance of rates. The negotiated rates shall be accepted by all Federal agencies. Only under special circumstances, when required by law or regulation, may an agency use a rate different from the negotiated rate for a class of sponsored agreements or a single sponsored agreement.

c. Correcting deficiencies. The cognizant agency shall negotiate changes needed to correct systems deficiencies relating to accountability for sponsored agreements. Cognizant agencies shall address the concerns of other affected agencies, as appropriate.

d. Resolving questioned costs. The cognizant agency shall conduct any necessary negotiations with an educational institution regarding amounts questioned by audit that are due the Federal Government related to costs covered by a negotiated agreement.

e. Reimbursement. Reimbursement to cognizant agencies for work performed under Circular A-21 may be made by reimbursement billing under the Economy Act, 31 U.S.C. 1535.

f. Procedure for establishing facilities and administrative rates. The cognizant agency shall arrange with the educational institution to provide copies of rate proposals to all interested agencies. Agencies wanting such copies should notify the cognizant agency. Rates shall be established by one of the following methods:

(1) Formal negotiation. The cognizant agency is responsible for negotiating and approving rates for an educational institution on behalf of all Federal agencies. Non-cognizant Federal agencies, which award sponsored agreements to an educational institution, shall notify the cognizant agency of specific concerns (i.e., a need to establish special cost rates) which could affect the negotiation process. The cognizant agency shall address the concerns of all interested agencies, as appropriate. A pre-negotiation conference may be scheduled among all interested agencies, if necessary. The cognizant agency shall then arrange a negotiation conference with the educational institution.

(2) Other than formal negotiation. The cognizant agency and educational institution may reach an agreement on rates without a formal negotiation conference; for example, through correspondence or use of the simplified method described in this Circular.

g. Formalizing determinations and agreements. The cognizant agency shall formalize all determinations or agreements reached with an educational institution and provide copies to other agencies having an interest.

h. Disputes and disagreements. Where the cognizant agency is unable to reach agreement with an educational institution with regard to rates or audit resolution, the appeal system of the cognizant agency shall be followed for resolution of the disagreement.

11. In Section J, replace subsection 8.f.(2) to read as follows:8.f.(2) Fringe benefits in the form of employer contributions or expenses for social security, employee insurance, workmen's compensation insurance, tuition or remission of tuition for individual employees are allowable, provided such benefits are granted in accordance with established educational institutional policies, and are distributed to all institutional activities on an equitable basis. Tuition benefits for family members other than the employee are unallowable for fiscal years beginning after September 30, 1998. See Section J.41.b, Scholarships and student aid costs, for treatment of tuition remission provided to students. 12. In Section J, add subsection 12.b.(3) to read as follows:12.b.(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. 13. In Section J, add subsection 12 c.(4) to read as follows:12.c.(4) Notwithstanding subsection(3), once an educational 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(3). 14. In Section J, amend subsections 16.a.(1) and 16.b.(2) to read as follows:16.a.(1) "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. 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. 16.b.(2) Expenditures for special purpose equipment are allowable as direct charges with the approval of the sponsoring agency. 15. In Section J, add subsection 22.f to read as follows:22.f. Interest on debt incurred after the effective date of this revision to acquire, replace or renovate capital assets (including renovations, alterations, equipment, land, and capital assets acquired through capital leases), acquired after the effective date of this revision and used in support of sponsored agreements is subject to the following conditions:

(1) For facilities costing over \$500,000, the educational institution shall prepare, prior to the acquisition or replacement of the facility, a lease-purchase analysis in accordance with 25.44 of OMB Circular A-110, which shows that a financed purchase, including a capital lease is less costly to the educational institution than other operating lease alternatives, on a net present value basis. Discount rates used shall be equal to the educational institution's anticipated interest rates and



shall be no higher than the fair market rate available to the educational 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 educational 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 educational 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 educational 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) Educational institutions are also subject to the following conditions:

(a) For debt arrangements over \$1 million, unless the educational institution makes an initial equity contribution to the asset purchase of 25 percent or more, educational institutions 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, educational 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.

(b) 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.

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

(6) The following definitions are to be used for purposes of this section:

(a) "Initial equity contribution" means the amount or value of contributions made by non-Federal entities for the acquisition of the asset prior to occupancy of facilities.

(b) "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).

16. In Section K, add an instruction and subsection 2.b(5) under the "Certificate of F&A Costs" to read as follows: For educational institutions that are required to file a DS-2 in accordance with Section C.14, the following statement shall be added to the "Certificate of F&A Costs":

(5) The rate proposal is prepared using the same cost accounting practices that are disclosed in the DS-2, including its amendments and revisions, filed with and approved by the cognizant agency.

17. Throughout the entire Circular, except for in Appendices A and B, replace the term "indirect costs" with "facilities and administrative costs" and make the following additional amendments:

a. In Section B, add the definition of facilities and administrative (F&A) costs to read as follows:

4. Facilities and administrative (F&A) costs, for the purpose of this Circular, means costs that are incurred for common or joint objectives and, therefore, cannot be identified readily and specifically with a particular sponsored project, an instructional activity, or any other institutional activity. F&A costs are synonymous with "indirect" costs, as previously used in this Circular and as currently used in Appendices A and B. The F&A cost categories are described in Section F.1.

b. In Section E, replace subsection 1 to read as follows:

1. General. F&A costs are those that are incurred for common or joint objectives and therefore cannot be identified readily and specifically with a particular sponsored project, an institutional activity, or any other institutional activity. See Section F.1 for a discussion of the components of F&A costs.

c. In Section E, replace subsection 2.e.(1) to read as follows:

2.e.(1) F&A costs are the broad categories of costs discussed in Section F.1.

d. In Section F, replace the first sentence of subsection 1 to read as follows:

1. Definition of Facilities and Administration. F&A costs are broad categories of costs.

18. Add Appendices A and B for the CASB's Cost Accounting Standards (CAS) and the CASB's Disclosure Statement (DS-2).19. In OMB's recompilation of Circular A-21 and its six Transmittal Memoranda, throughout the Circular, consistent conventions were introduced, including some numbering changes, punctuation changes, correction of typographical errors, etc. In addition, in Section J, former subsections 29, "Public information services costs," and 39, "Special services costs," were removed since their contents were merged into subsections 1 and 3 in Transmittal Memorandum No. 4. BILLING CODE 3110-01-M

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### **A-21 Excess Cash-Flow Calculation - Sample Format for Annual Report**

Applicable for debt arrangements over \$1 million, unless initial equity contribution equals 25 percent or more  
Month 1 2 3 4 ..... 12 Annual Total  
Year \_\_\_\_ of \_\_\_\_ Years  
Line 1 -- Prior period's cumulative cash flow balance  
(Prior Month's or Year's Line 9) Add this period's inflows: Line 2 -- Depreciation expense (Note 1)

Line 3 -- Interest expense (Note 2)

Line 4 -- Amortization of debt issuance costs (Note 2) Subtract this period's outflows: Line 5 -- Principal payments (Note 3)

Line 6 -- Interest payments (Note 3) Line 7 -- Subtotal of cumulative cash flows (Line 1+2+3+4-5-6) Line 8 -- In initial period only, subtract initial equity contribution (Note 4)

(Will be zero after initial period) Line 9 -- Total of cumulative cash flows (In initial period, Line 7 - Line 8)

(In subsequent periods, equals Line 7) Line 10 -- If line 9 is positive, state month's closing interest rate on 3-month Treasury Bill

If line 9 is negative, put "0" (zero) Line 11 -- Imputed interest income on cumulative positive cash flow

Monthly columns = (Line 10 x Line 9)/12 Line 12 -- Allowable interest for period (Line 6 - Line 11)

**Note 1:** May include amortization of capitalized construction interest in accordance with GAAP. Depreciation expenses should be reported on a monthly basis (Annual expense/12).

**Note 2:** Interest expense and amortization of debt issuance costs that are not included in loan amount should be reported on a monthly basis (Annual expense/12).

**Note 3:** If land is included in the financing arrangement, Line 5 would be calculated as: principal payment - (Debt proceeds used to purchase land / total debt proceeds x principal payment). Principal and interest payments should be reported in the month that payments were made.

**Note 4:** This line may only include amounts of initial equity contribution made prior to occupancy of the facility. The amount is to be entered only in the initial period covered by the cash flow submission, and should be left blank in future periods.