HKA

FELDESMAN + TUCKER LEIFER + FIDELL LLP

Cost Accounting Requirements For Nonprofits That Service Federal Awards And The Consequences Of Noncompliance

Agenda

1. ***Uniform Guidance: Primer***
2. Cost Principles
3. Basic Considerations
4. Direct And Indirect Costs
5. Selected Items Of Cost
6. Negotiation And Approval Of Indirect Cost Rates
7. Program Income
8. Sourcing Limitations And Domestic Preferences
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For Illustrative Purposes Only

Uniform Guidance: Primer

- The Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards (“Uniform Guidance”), 2 C.F.R. § 200
- Prescribes pre- and post-award requirements for federal financial assistance agreements (e.g., grants and cooperative agreements), including special accounting rules and audit requirements for recipients and subrecipients
  - Procurement contracts are generally subject to Federal Acquisition Regulation (FAR) and agency supplements (e.g., Defense FAR Supplement [DFARS])
- Supersedes requirements from earlier OMB circulars; substantial revision effective August 13, 2020 & November 12, 2020

Uniform Guidance: Primer (Cont.)

- As defined in the Uniform Guidance, a nonprofit organization is an organization which:
  1. Is operated primarily for scientific, educational, service, charitable, or similar purposes in the public interest;
  2. Is not organized primarily for profit; and
  3. Uses net proceeds to maintain, improve, or expand its operations.
- A “Federal award” is Federal financial assistance (e.g., grant, cooperative agreement, loan), or cost-reimbursement type contract under FAR, received directly from a Federal agency or indirectly from a pass-through entity,
- The Federal award will set forth applicable terms and conditions, which “flow down”
- For cost-reimbursement contracts, certain sections will apply as supplements to the contract terms & conditions; terms of FAR-based contracts will control

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Cost Principles

- Negotiated procurement contracts under the FAR, grants, and cooperative agreements must generally comply with the cost principles in Subpart E of the Uniform Guidance (2 C.F.R. § 200.101)
- The cost principles must also be used as a guide in pricing of fixed-price contracts and subcontracts when costs are used as a basis to determine price (2 C.F.R. § 200.401)
- Certain nonprofit organizations, because of their size and the nature of their operations, must comply with the cost principles in FAR Part 31 instead of Uniform Guidance Subpart E
  - 2 C.F.R. § 200 Appendix VIII lists such organizations

Cost Principles (Cont.)

Uniform Guidance v. FAR v. Cost Accounting Standards

- **FAR Subpart 31.7 (Contracts With Nonprofit Organizations)**
  - Stipulates that the cost principles of the Uniform Guidance shall be the standard to determine allowable costs under Federal work performed by most nonprofit organizations
  - Further stipulates that Federal agencies are not expected to place additional restrictions on costs beyond those in the Uniform Guidance
- **Cost Accounting Standards (CAS)**
  - Governs the measurement, assignment, and allocation of costs to contracts and subcontracts
  - Applies to contracts and subcontracts if certain thresholds are met
  - If CAS applies to a contract, its provisions take precedence over the cost principles within the Uniform Guidance
  - Certain CAS allocation provisions differ from those of the Uniform Guidance
  - Compliance with certain CAS (e.g., CAS 410) requires adoption of cost accounting practices that implicate all cost objectives of an organization, not just contracts or subcontracts that an entity holds that are subject to CAS

Cost Principles (Cont.)

The “Deal” under a grant agreement:

- If you (grantee) engage in *certain activities*, during a *certain period of time*, we (the U.S. government) will “reimburse” you for *certain costs* incurred in engaging in that activity.
- Caveats:
    1. “Reimburse” costs, but actually advance funds in most cases;
    2. Some flexibility in defining the activity (as opposed to budget) over time, but what you said in your grant application matters; and
    3. Not reimbursing *all* costs, just certain costs

Cost Principles (Cont.)

Factors affecting allowability of costs (2 C.F.R. § 200.403):

- Necessary
- Reasonable
- Allocable

(generally addressed together)

- Conform to limitations of the Cost Principles, including requirements applicable to Selected Items of Cost
- Adequately documented
- Consistent with policies applicable to both federally-funded and non-federally-funded activities
- Consistent treatment in designating as direct or indirect

Cost Principles (Cont.)

Typical grant budget (SF 424A Budget Categories):

Budget Category	Federal	Non-Federal
a. Personnel		
b. Fringe Benefits		
c. Travel		
d. Equipment		
e. Supplies		
f. Contractual		
g. Construction		
h. Other		
i. Total Direct Charges		
j. Indirect Charges		
k. TOTALS		

**Note: construction budget categories are different

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Basic Considerations

(See 2 C.F.R. §§ 200.402 – 200.411)

1. Composition of costs (i.e., what is the total cost of Federal award?)
2. Factors affecting the allowability of costs (e.g., costs must be necessary and reasonable)
3. Reasonable costs (i.e., what is a reasonable cost?)
4. Allocable costs (i.e., when is a cost considered allocable?)
5. Applicable credits (e.g., how should credits be accounted for?)
6. Prior written approval (e.g., advance approval for the treatment of unusual costs)
7. Limitation on allowance of costs (i.e., statutory limitations on the allowability of costs)
8. Special considerations (e.g., special considerations for state and local governments)
9. Collection of unallowable costs (i.e., requirements to repay costs deemed to be unallowable)
10. Adjustment of previously negotiated indirect cost rates containing unallowable costs (i.e., how to adjust indirect cost rates to remove unallowable costs).

Basic Considerations (Cont.)

Allowable Costs are:

- Necessary and reasonable for award performance and allocable to the award;
- In conformance with any limitations or exclusions set forth in the Uniform Guidance or the award;
- Consistent with policies and procedures that apply uniformly to both federally-financed and other activities of an organization;
- Accorded consistent treatment;
- Determined in accordance with generally accepted accounting principles (GAAP);
- Not included as a cost or used to meet cost sharing or matching requirements of any other Federally-financed program;
- Adequately documented; and
- Incurred during the approved budget period, unless waived pursuant to § 200.308(e)(3).

Basic Considerations (Cont.)

<u>Credits</u>

- Receipts or reduction of expenditures that offset or reduce expense items that are allocable to awards as direct or indirect costs
- Typical examples include:
  - Purchase discounts
  - Rebates or allowances
  - Recoveries or indemnities on losses
  - Insurance refunds
  - Adjustments of overpayments or erroneous charges.
- To the extent such credits accruing to or received relate to allowable costs, they must be credited to the Federal award as a cost reduction or cash refund

Basic Considerations (Cont.)

<u>Collection of Unallowable Costs</u>

- Payments of costs determined to be unallowable must be refunded
- Refunded amounts include interest
- Can include direct or indirect costs
- Note that there can potentially be other implications from claiming unallowable costs (e.g., termination)

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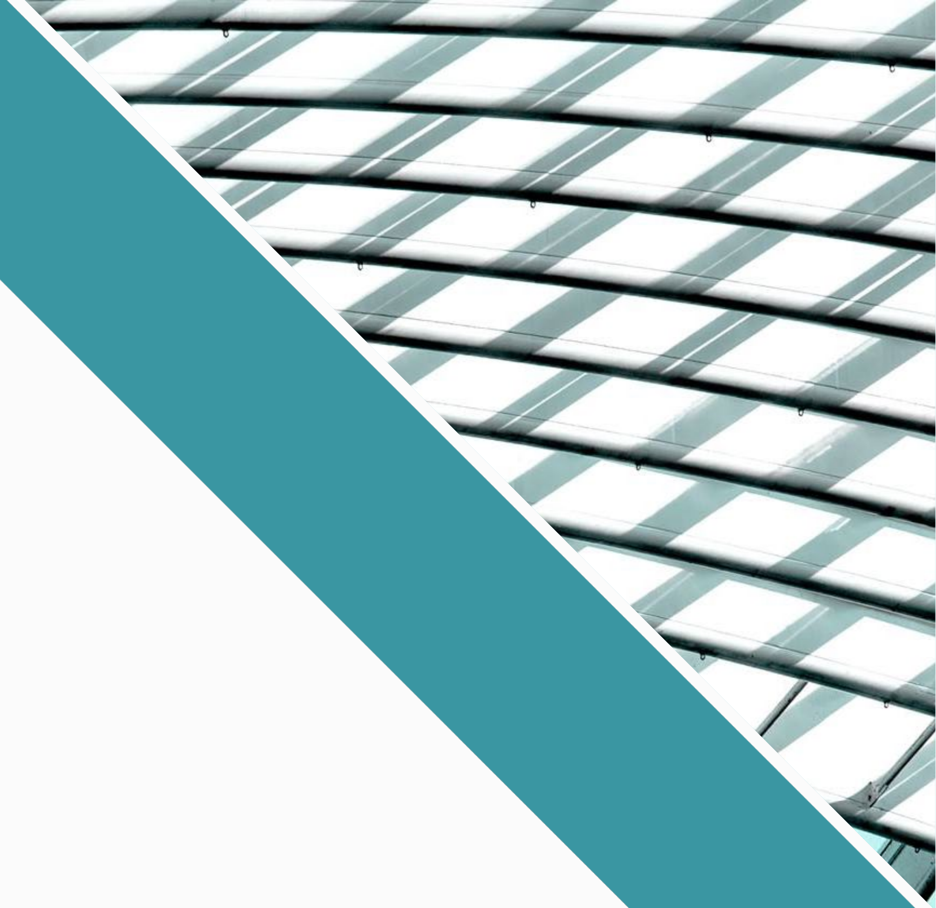

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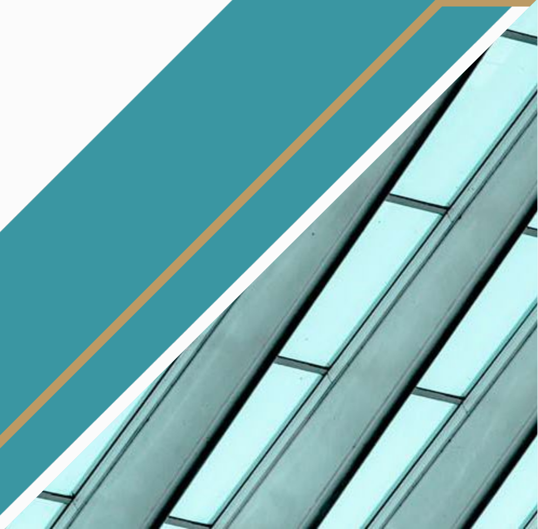


Direct And Indirect Costs

Classification of Costs (2 C.F.R. §§ 200.412-13; Appendix IV)

- **Direct costs:** Costs that can be identified specifically with a particular final cost objective (i.e., a particular award, project, service, or other direct activity of an organization)
- **Indirect costs**: Costs that have been incurred for common or joint objectives and cannot be readily identified with a particular final cost objective
- Each item of cost incurred for the same purpose must be treated **consistently** in like circumstances either as a direct or an indirect cost to avoid possible double-charging

Direct And Indirect Costs (Cont.)

Indirect Costs (2 C.F.R. § 200.414)

- Organizations receiving **more than $10 million** in Federal funding of direct costs in a fiscal year **must breakout indirect costs** between "Facilities" and "Administration" (F&A)
  - "Facilities" (e.g., depreciation, equipment, and capital improvements)
  - "Administration" (e.g., director's office, accounting, and other categories of costs that would not be considered Facilities)

Direct And Indirect Costs (Cont.)

<u>Allocation of Indirect Costs</u> (2 C.F.R. § 200 Appendix IV)

Types of Allocation Methods:

- Simplified Allocation Method
- Direct Allocation Method
- Multiple Allocation Base Method
- Special Indirect Cost Rates

Direct And Indirect Costs (Cont.)

- Fair and consistent distribution is a key requirement
- Costs must be distributed using a method (*i.e.*, basis, or base) that fairly attributes portions of the cost to benefitting cost centers. 2 C.F.R. § 200.405(d) states:

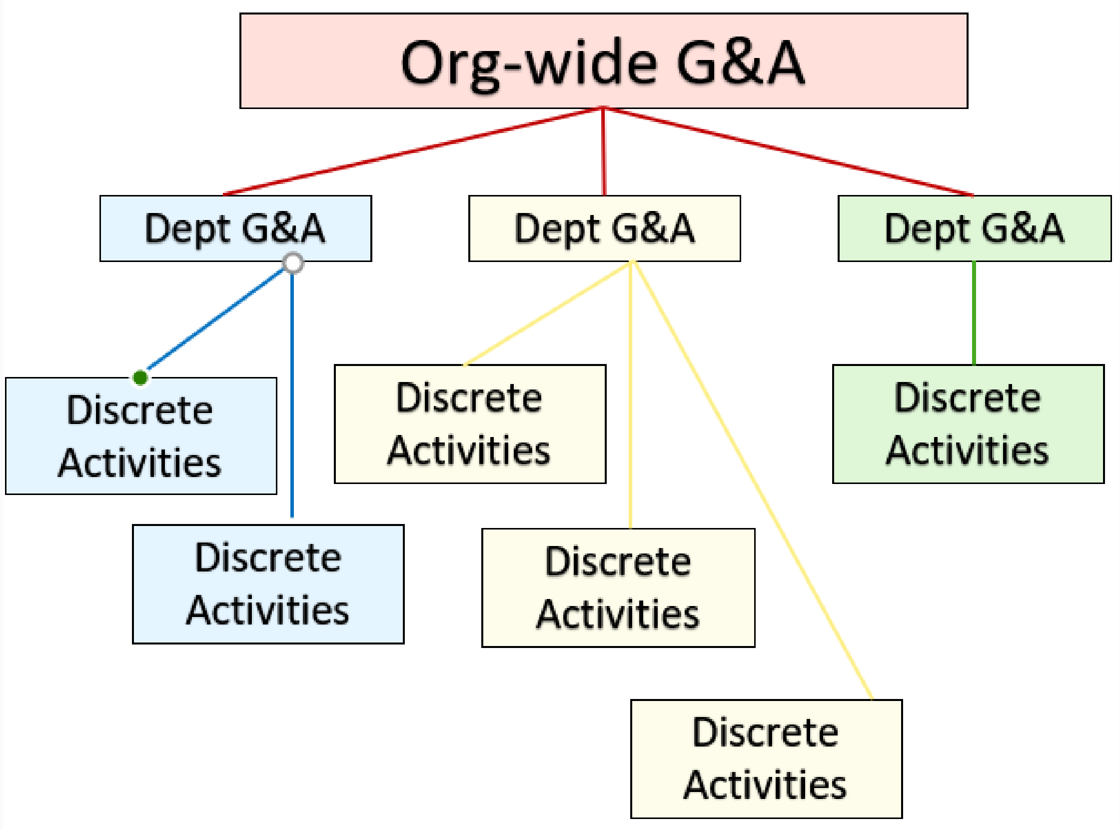
  > "If a cost benefits two or more projects or activities in proportions that can be determined without undue effort or cost, the cost must be allocated to the projects based on the proportional benefit. If a cost benefits two or more projects or activities in proportions that cannot be determined because of the interrelationship of the work involved, then . . . the costs may be allocated or transferred to benefitted projects on any reasonable documented basis. . ."

- The proportional share of the cost must reasonably approximate the proportional degree to which the "receiving" cost center benefits from the cost (see 2 C.F.R. § 200.405(a))
- Examples:
  - Distribute facility costs, where the facility is used by multiple "business lines," on the proportional basis of square feet of the facility used by each cost objective
  - Distribute HR Department costs, where the entity has multiple "business lines," on the proportional basis of direct salaries and wages attributable each month to each cost objective

Direct And Indirect Costs (Cont.)

The conceptual big picture:

- Develop a documented "cost allocation plan"
- Start by conceptualizing your "business lines" or "major functions"
- Consider your overall administrative costs
- Consider your "departmental" or "divisional" overhead/G&A costs
- Establish bases for distribution that are fair and administrable



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Selected Items Of Cost

- 2 C.F.R. §§ 200.420-475 Provides principles for the allowability of selected items of cost
- Most cost principles are **similar or substantially the same** as in FAR Part 31
  - Examples: Bad debts; Bonding costs; Entertainment
- Some costs are **treated differently** in the Uniform Guidance than in FAR Part 31
  - Examples: Employee morale, Health and welfare costs; Interest
- Other items are **unique** to the Uniform Guidance
  - Examples: Advisory councils; Fundraising

Selected Items Of Cost (Cont.)

- The “biggest” shared cost is typically labor; special allocation-focused documentation requirements
- Time and effort documentation for allocation of personnel expenses (2 C.F.R. § 200.430(i)) must:
  - Accurately reflect the work performed
  - Be supported by a system of internal control that provides a reasonable assurance that charges are “accurate, allowable, and properly allocated”
  - Reflect total activity of the individual’s compensated time (representation as percentage ok – in fact, best practice under the Uniform Guidance)

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Negotiation And Approval Of Indirect Cost Rates

Types of Indirect Cost Rates (2 C.F.R. § 200 Appendix IV)

- **Predetermined rate** – Based on an estimate and not subject to adjustment
- **Fixed rate** – Based on an estimate and subject to adjustment that represents the difference between actual and estimated costs (carried forward as an adjustment to the subsequent period)
- **Final rate** – Based on actual costs and not subject to adjustment
- **Provisional rate/billing rate** – A temporary rate used for funding, interim reimbursement, and reporting indirect costs on Federal awards pending the establishment of a final rate

Negotiation And Approval Of Indirect Cost Rates (Cont.)

Negotiation and Approval

- Unless different arrangements are agreed to by the agencies concerned, the Federal agency with the largest dollar value of awards with an organization will be designated as the cognizant agency for negotiation and approval of indirect cost rates
- For organizations with no prior approved indirect cost rate, a provisional proposal must be submitted no later than three months after the effective date of the award (preferably immediately after the notice of award)
- Organizations must submit a new indirect cost proposal on an annual basis to the cognizant agency no later than six months after the close of each fiscal year, unless an exception is approved

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Program Income (2 C.F.R. § 200.80; § 200.307; § 200.400)

- Organizations may not retain profit resulting from Federal financial assistance, unless authorized
- Program income is gross income directly generated by a supported activity or earned as a result of the Federal award during the award's period of performance
- Examples include fees for services performed, license fees, and royalties
- The awarding agency's regulations or an award's terms and conditions may specify how program income is to be used
- Absent regulatory or contractual limitations, program income may be used in one of three methods:
    1. Added to project budget
    2. Deducted from allowable outlays
    3. Used to meet cost sharing or matching requirements

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Sourcing Limitations And Domestic Preferences

2 C.F.R. § 200.321:

Must use small businesses, labor surplus area concerns, minority-owned businesses, and women's business enterprises "when possible."

2 C.F.R. § 200.322:

"As appropriate and to the extent consistent with law . . . to the greatest extent practical under a Federal award" apply domestic preferences for "goods, products, or materials"

Now, by Statutory Mandate:

- Section 889 "Huawei ban" – August 13, 2020
- Build America Buy America – Per the IIJA of Nov. 15, 2021, currently undergoing initial implementation (though agency approaches vary)

Sourcing Limitations And Domestic Preferences (Cont.)

- Prohibition on certain telecommunications and video surveillance services or equipment (2 C.F.R. § 200.216):

  Recipients and subrecipients are prohibited from obligating or expending loan or grant funds to procure or obtain; extend or renew a contract to procure or obtain; or enter into a contract (or extend or renew a contract) to procure or obtain equipment, services, or systems that uses *covered telecommunications equipment or services as a substantial or essential component of any system*, or as critical technology as part of any system.

Note: Implemented also by reference in 2 C.F.R. Part 200, Appendix II, but the source is not a limitation in the procurement standards. Therefore, this applies to state agencies as well.

Sourcing Limitations And Domestic Preferences (Cont.)

Uniform Guidance preamble cites to statutory definition of "Covered Telecommunications Equipment":

- Telecommunications equipment produced by Huawei Technologies Company or ZTE Corporation (or any subsidiary or affiliate of such entities)
- For the purposes of *public safety, security of government facilities, physical security surveillance* of critical infrastructure, and other national security purposes, video surveillance and telecommunications equipment produced by Hytera Communications Corporation, Hangzhou Hikvision Digital Technology Company, or Dahua Technology Company (or any subsidiary or affiliate of such entities)
- Telecommunications or video surveillance *services* provided by such entities or using such equipment
- Telecommunications or video surveillance equipment or services produced or provided by an entity that the Secretary of Defense . . . reasonably believes to be an entity owned or controlled by, or otherwise connected to, the government of [the People's Republic of China].

Sourcing Limitations And Domestic Preferences (Cont.)

Infrastructure Investment and Jobs Act, Pub. L. 117-58 (Nov. 15, 2021)

- Sec. 70914 sets government-wide baseline standard for fed-funded infrastructure:

  "Not later than 180 days after the date of enactment of this Act, the head of each Federal agency shall ensure that none of the funds made available for a *Federal financial assistance program for infrastructure*, including each deficient program, *may be obligated for a project* unless *all of the iron, steel, manufactured products, and construction materials* used in the project are produced in the United States.

- Material Categories and Statutory Definitions of "Produced in the United States" (Sec. 70912(6)):
  - All iron and steel:

    ". . . all manufacturing processes, from the initial melting stage through the application of coatings, occurred in the United States".

- Material Categories and Statutory Definitions of "Produced in the United States" (Sec. 70912(6)):
  - All manufactured products:

    (i) The manufactured product was manufactured in the United States; and

    (ii) The cost of the components of the manufactured product that are mined, produced, or manufactured in the United States is greater than 55 percent of the total cost of all components of the manufactured product, unless another standard for determining the minimum amount of domestic content of the manufactured product has been established under applicable law or regulation . . ."

  - All construction materials:

    ". . . All manufacturing processes for the construction material occurred in the United States."

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Consequences of Noncompliance (2 C.F.R. §§ 200.338 - 200.342)

- Failure to comply with applicable statutes, regulations, and terms and conditions carries significant financial and reputational risk
- Remedies include:
  - Additional conditions/requirements, oversight (e.g., additional financial reports, project reporting, etc.)
  - Temporary withholding of cash payments pending corrective action
  - Cost disallowance related to the noncompliant activity/action
  - Restriction from further Federal awards for the project or program
  - Termination for cause (must be reported)
  - Suspension or debarment from future federal awards/contracts
  - Criminal and civil penalties
  - Other available legal remedies

Consequences of Noncompliance (cont.)

- DOJ, Offices of Inspector General have stepped up enforcement actions against grant recipients for alleged noncompliance
- Cases often involve alleged misstatements on grant applications or other representations in connection with the agreement; inaccurate reporting due to a lack of internal controls (e.g., accounting, timekeeping); and mischarging time/costs to as direct costs
- For example:
    - **September 2020**: **$10 million FCA settlement** to resolve allegations of mischarging NIH-sponsored research grants; alleged that non-profit failed to have a system in place for its faculty to properly account for time spent on activities that cannot be charged directly to NIH-funded projects or are unrelated to the research activities of the NIH-funded project, such as time spent by faculty on developing, preparing, and writing new grant applications directly to existing NIH-funded projects, rather than allocating such charges as indirect costs, and time spent by its faculty on other activities unrelated to the funded projects, such as teaching, TSRI committee work, and other administrative tasks.

Consequences of Noncompliance:
Suspension And Debarment (2 C.F.R. § 200.213, 2 C.F.R. Part 180)

- Purpose is to ensure the Federal government does business with organizations that are "presently responsible"
  - Bases for suspension or debarment include "Any other cause of so serious or compelling a nature that it affects your present responsibility."
- Operates to exclude persons (organizations *and* individuals) from participation in federal awards, including procurement contracts
  - May cover parts, or entire, organization
  - Excluded parties listed in SAM
- Suspension is temporary exclusion pending investigation and determination to protect Government's interest
  - Up to 12-18 months, or conclusion of debarment proceedings if initiated
- Debarment is for specific period of time (generally up to 3 years) when determined that person is not presently responsible

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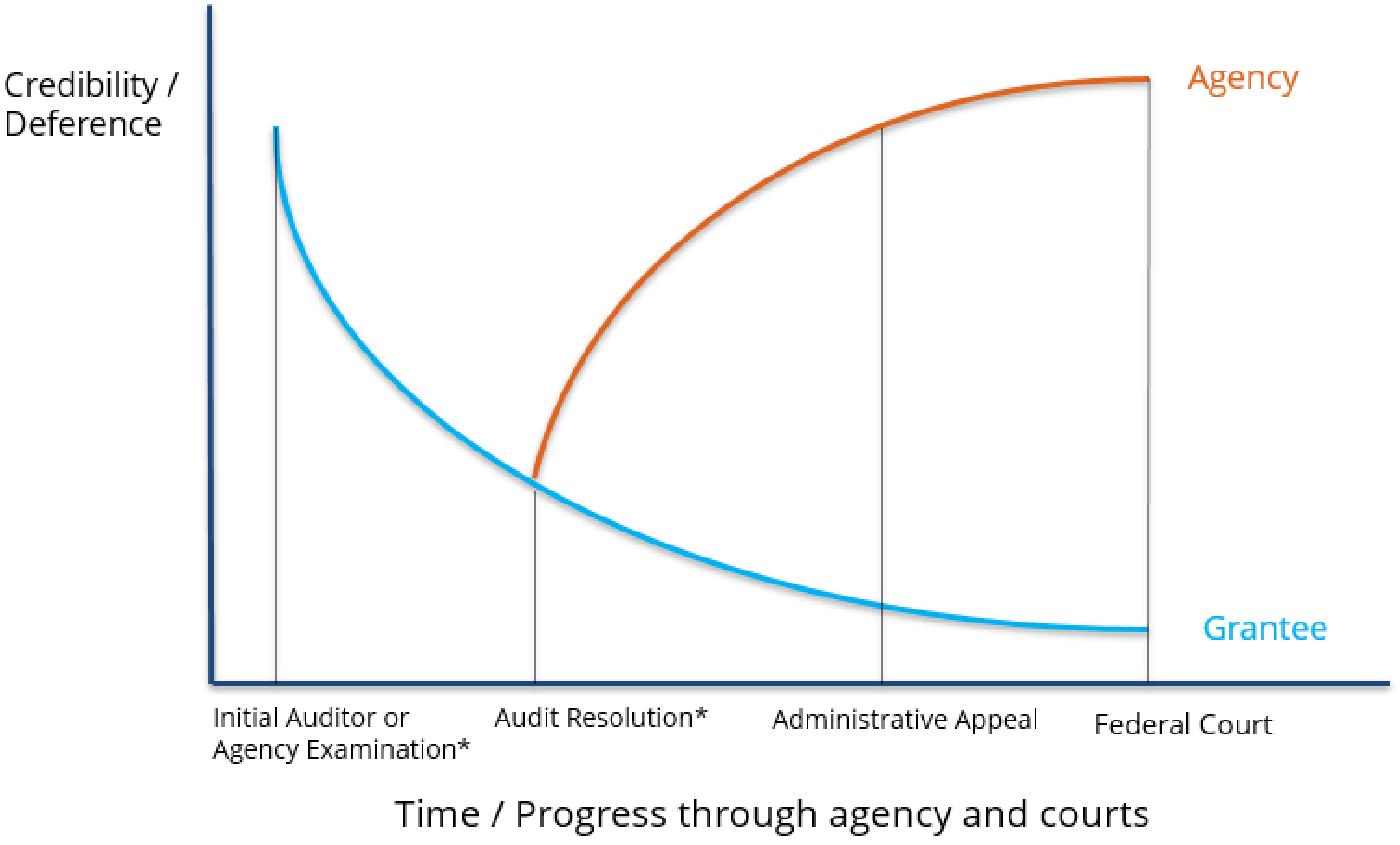
Mandatory Disclosure (2 C.F.R. § 200.113)

- Similar to mandatory disclosure rule under FAR 52.203-13
- Requires timely disclosure, in writing, to the Federal awarding agency or pass-through entity, of all violations of Federal criminal law involving fraud, bribery, or gratuity violations *potentially* affecting the Federal award.
- Failure to make required disclosure can lead to severe consequences, including suspension and/or debarment.
- Ensure processes are in place to detect and identify potential violations to ensure “timely” disclosure when required

Mandatory Disclosure (2 C.F.R. § 200.113) (Cont.)



*Exception: OIG can be more strict in view than agency.

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Best practices

- Understand the requirements
- Develop compliant and sound policies, procedures, and internal controls in relevant functional areas, including Accounting, Purchasing, Proposal Management, and Contracts/Grant Management
- Identify personnel that are implicated by compliance requirements and provide regular training to ensure compliance and mitigate risk
- Ensure timekeeping and accounting systems provide for project-based recording and reporting and track charges associated with performance of grant(s)
- Periodically assess compliance (e.g., internal audit, legal review)

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