

**DEPARTMENT OF HOUSING AND COMMUNITY DEVELOPMENT
DIVISION OF FINANCIAL ASSISTANCE
FEDERAL PROGRAMS BRANCH**

Community Development Block Grant (CDBG) Program

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CDBG

Community Development Block Grant Program

MANAGEMENT MEMORANDUM

Memorandum Number 12-02

DATE: April 5, 2012

TO: Non-Entitlement Jurisdictions Eligible for the State Community Development Block Grant (CDBG) Program, Disaster Recovery Initiative (DRI) and Neighborhood Stabilization Program (NSP)

FROM: Thomas Brandeberry, CDBG Section Chief 

SUBJECT: Office of Management and Budget (OMB) Circular A-87 and OMB Circular A-122

The purpose of this management memo is to incorporate the policies and requirements of OMB Circular A-87: Cost Principles for State, Local and Indian Tribal Governments (OMB A-87) and OMB Circular A-122: Cost Principles for Nonprofit Organizations (OMB A-122)

Federal CDBG regulations require that states, their grantee jurisdictions, and sub-recipients of their grantees, adhere to certain administrative requirements. These requirements include, among others: OMB Circular A-87 "Cost Principles for State, Local and Indian Tribal Governments" and OMB Circular A-122 "Cost Principles for Nonprofit Organizations." These circulars establish principles and standards for determining allowable costs under Federal grants.

The Department is currently incorporating OMB Circulars A-87 and A-122 by:

- Updating the 2012 CDBG Grant Agreement language to incorporate A-87 and A-122.
- Preparing to incorporate OMB A-87 and A-122 into CDBG State Regulation.
- Preparing to revise the Grant Management Manual over the next 24 months to include OMB A-87 and A-122 in the appropriate fiscal and contracting sections.

How OMB A-87 and A-122 Apply to State CDBG:

OMB A-87 applies to governmental entities and governmental entity sub-recipients. OMB A-122 applies to all nonprofit sub-recipients. They both establish principles and standards for determining allowable costs under Federal Grants in the areas of **financial management, procurement and contracting**. All grantee fiscal operations, contracts and sub-recipient agreements must consider, and reference appropriately, OMB A-87 and, if applicable, OMB A-122.

CDBG program operators must review vouchers and invoices to ensure the costs are allowable under regulations, approved under the scope of work as applied for in the Grant Application, allocated to the correct program activity, and are reasonable. Guidelines for allowable and reasonable costs are provided in A-87. **The recipient is responsible for reviewing and certifying that its financial management system (24 CFR Part 85), as well as those of any sub-recipients, comply with A-87 and A-122 as applicable.**

OMB Circular A-87 can be accessed at: [OMB Circular A-87](#).
OMB Circular A-122 can be accessed at: [OMB Circular A-122](#)

How OMB A-87 and A-122 are applied:

OMB Circulars A-87 (state and local governments) and A-122 (nonprofits) provide basic guidelines for determining whether a cost is allowable.

Allowable costs must meet the following general criteria:

- Be necessary and reasonable for proper and efficient performance and administration of the federal award;
- Be allocable to the federal award under the provisions of the OMB circulars (see below);
- Be authorized or not prohibited under state or local laws or regulations;
- Conform to any limitations or exclusions set forth in the OMB circulars, federal laws, terms and conditions of the federal award, or other governing regulations as to types or amounts of cost items;
- Be consistent with policies, regulations and procedures that apply uniformly to both federal awards and other activities of the governmental unit;
- Be accorded consistent treatment; a cost may not be assigned to the CDBG program as a direct cost if any other cost incurred for the same purpose in like circumstances has been allocated to the program as an indirect cost;
- Be determined in accordance with generally accepted accounting principles;
- Not be included as a cost or used to meet cost sharing or matching requirements of any other federal award in the current or a prior period, except as specifically provided by federal law or regulation;
- Be the net of applicable credits (that is, any credits such as discounts or price adjustments must be deducted from the total costs charged); and
- Be adequately documented.

Attachment B of OMB A-87 is a “selected” list of costs that are allowable or unallowable. However, the fact that an item of cost is not included does not mean it’s unallowable.

Cost Allocation

As mentioned previously, costs charged to CDBG must also be allocable to the CDBG program. A cost is allocable if it:

- Is treated consistently with other costs incurred for the same purpose in like circumstances (i.e., states/grantee must treat costs consistently for all grant programs); and
 - Is incurred specifically for the CDBG program;
 - Benefits both the CDBG program and other work and can be distributed in reasonable proportion to the benefits received; or
 - Is necessary to the overall operation of the organization, although a direct relationship to any particular cost objective cannot be shown.

Any costs allocable to a particular federal award or cost objective (such as CDBG) may not be charged to other federal awards to overcome funding deficiencies, to avoid restrictions imposed by law or the terms of the federal award, or for other reasons.

Indirect Costs - OMB Circular A-87 (State and Local Governments)

A-87 requires governmental entities to support indirect costs with a cost allocation plan or an indirect cost proposal prepared in accordance with the circular. Indirect costs should be allocated in a manner which will result in the grant program bearing its fair share of total indirect costs.

- A **central service cost allocation plan** is required if the local government has indirect costs resulting from centralized services that will be charged to federal awards.
 - A central service cost allocation plan, for the purposes of local governments, refers to a description of a process whereby services provided on a centralized basis (e.g., motor pools, computer centers, purchasing and accounting services) can be identified and assigned to benefited departments/agencies (e.g., the department/agency administering the CDBG program) on a reasonable and consistent basis.
 - Refer to Attachment C of OMB Circular A-87 for additional information.
- An **indirect cost proposal** is required if the local government has indirect costs resulting from centralized services that will be charged to federal awards and other indirect costs originating in various departments/agencies carrying out federal awards.
 - An indirect cost proposal is the documentation prepared by a governmental entity to substantiate its request for the establishment of an indirect cost rate. This rate, expressed in percentage terms, is applied to direct costs in order to determine the amount of reimbursement a state can obtain for indirect costs.
 - For instructions on preparing indirect cost proposals, refer to Attachment E of OMB Circular A-87.

Indirect Costs - OMB Circular A-122 (Nonprofits)

Under OMB Circular A-122, there are three methods nonprofits are required to utilize for allocating indirect costs. Each method is applicable to certain specific circumstances.

Simplified allocation method:

Used when a nonprofit organization has only one major function, or where all its major functions benefit from its indirect costs to approximately the same degree.

The indirect cost rate is calculated by separating the organization's total costs for the base period (e.g., fiscal year) as either direct or indirect, and dividing the total allowable indirect costs by an equitable distribution base (total direct costs, direct salaries or other equitable distribution base).

Multiple allocation base method:

Used when major functions benefit in varying degrees from indirect costs. Costs are separated into distinct groupings, and each grouping is then allocated to benefiting functions by means of a base which best measures relative benefits. An indirect cost rate must be developed for each grouping.

Direct allocation method:

This method may be used for those nonprofits that treat all costs as direct costs *except* general administration and general expenses.

These joint costs are prorated individually as direct costs to cost objectives using a base most appropriate to the particular cost being prorated. The base must be established in accordance with reasonable criteria and must be supported by current data.

Indirect cost rates determined through one of the three prescribed methods must be submitted to and approved by the Department prior to execution of the required written agreement between the jurisdiction and the nonprofit. Thus, the Department must approve both the indirect cost rates, and the methodology used to determine them, as well as approve the content and terms of the written agreement regarding such, prior to execution of that agreement by either the jurisdiction or the nonprofit.