

**UNITED STATES DEPARTMENT OF EDUCATION****OFFICE OF THE CHIEF FINANCIAL OFFICER**

DEC 11 2006

Mr. Gilbert Tran
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Office of Management and Budget
Office of Federal Financial Management
225, 17th Street, NW
Room 6025, NEB
Washington, DC 20503

Re: Request for a Policy Clarification – Treatment of Indirect Cost Rates
Associated with Sub-recipients

Dear Gil:

The purpose of this letter is to confirm the longstanding cost policy concerning indirect cost determination responsibilities for entities who receive Federal funds through subawards.

Background

Federal grant funds often are initially awarded to a state or local government agency and then awarded to sub-recipients through subgrants or subcontracts. The first tier of sub-recipients may also award Federal funds to another lower tier of sub-recipients. In both scenarios the sub-recipients may be either governmental or non-governmental organizations.

With the increased emphasis on monitoring there are two questions that now need to be addressed. The first, "Who is responsible for the review and approval of sub-recipients indirect rates" and the second "How can the entity responsible for the sub-award fulfill its responsibilities with respect to this requirement"?

The Office of Management and Budget (OMB) Circular A-87, Attachment C, Paragraph D.3 and Attachment E, Paragraph D.1.b. notes that where a local unit of government receives funds as a sub-recipient, the primary recipient is responsible for negotiating indirect cost rates and/or monitoring the sub-recipient's plan. The general Federal policy is that agencies will not approve indirect cost rates when the organization does not receive direct Federal awards subject to indirect cost support. In these situations, Federal policy, as stated in the "OMB Circular A-87 Implementation Guide" (ASMB C-10), requires that the local unit of government prepare an indirect cost proposal in accordance with the applicable cost principles. This indirect cost rate needs to be developed on an annual basis that reflects the organizations actual, allowable costs for each applicable year.

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OMB Circular A-87 also notes that for "non-major" units of government that have not specifically been requested to submit an indirect cost proposal; a proposal must be prepared on an annual basis in accordance with the OMB Circular A-87 principles and held for audit. If an audit has not occurred during the retention of records period, the proposal may then be disposed of.

The "common rule" at Paragraph 92.40 (a) notes "... grantees must monitor grant and sub-grant compliance with applicable Federal requirements...", and although this section focuses more on reporting program performance rather than the fiscal aspects, it is still applicable (germane).

While ASMB C-10 provides that the primary recipient is responsible for negotiating indirect cost rates and/or monitoring the sub-recipients plan, there are no specific instructions as to how this responsibility should be carried out. It does note, however, that the primary recipient "...could require sub-recipients to develop the necessary documentation concerning indirect charges and retain the documentation for audit or review *audit reports* (emphasis added) to determine whether proper cost charging occurred." The DHEW Guide for State and local Governments (OASC-10) dated December 1976 contained the same basic language, however, it noted that lower tier organizations could be other than state and local governments and that the indirect costs should be determined in accordance with the applicable cost principles. The extension to other types of organizations was not picked up in the ASMB C-10 publication dated April 8, 1997.

However, neither OMB Circular A-87 itself nor the other cost principles, address situations where the local unit of government provides funds to lower tier organizations that are subject to the cost principles in OMB Circulars A-21, A-122 or the Federal Acquisition Regulations. In addition, these other cost principles do not address the "rippling" sub-awards situation at all.

Status

OMB Circulars only address federal cognizance where two federal agencies are involved and ASMB C-10 only addresses the primary/sub-recipient relationship and does not address sub-recipients at lower levels or sub-recipients at a lower level that are not state or local units of government. The Department of Education has developed a process by which its primary recipients (i.e., the State Education Agencies) can review and approve the sub-recipients (i.e., the Local Education Agencies) indirect cost rates. However, this formal process does not address situations where the sub-recipients make awards to another lower level or to grantees other than Local Education Agencies. Also, we recognize that all Federal agencies do not have formal arrangements with their primary recipients for the review of indirect rates proposed by their sub-recipients.

