



OFFICE OF THE CONTROLLER

CITY AND COUNTY OF SAN FRANCISCO

Ben Rosenfield
Controller

Todd Rydstrom
Deputy Controller

GUIDELINES FOR COST CATEGORIZATION IN NONPROFIT CONTRACTS AND GRANTS

SUMMARY

Per recommendations of the FY16-17 Mayor's Nonprofit Working Group, and in close consultation with the Mayor's Budget Office, City departments and nonprofits in San Francisco, the Controller's Office has developed guidance on the treatment and allowability of direct and indirect costs in City grants and contracts with nonprofit service providers.

See Appendix A for the budget matrix. The matrix represents general guidance on the treatment of direct and indirect costs, but it is not possible to specify the treatment of costs in every situation. Further, the matrix documents which cost categories are allowable in City contracts and grants, which may vary due to funding source restrictions. Departments may make choices about the budget items they prioritize for funding and may employ additional approval mechanisms or caps on certain cost categories.

The Controller's Office issues this budget matrix for adoption by all City departments administering contracts and grants with nonprofit service providers.

BACKGROUND

In 2010, the Controller's Office issued a memo in response to City department and nonprofit inquiries concerning nonprofit indirect cost rates. After analysis of federal guidelines, best practices, and discussions with City departments, the Controller's Office issued a memo including, among others, the finding that no single list can encompass the full extent of charges that may fall under an indirect cost category.

In subsequent years, there have been advancements in standardizing policies and procedures, most notably the OMB Uniform Guidance published in 2014. In FY16-17, with an interest in strengthening the partnership between the City and nonprofit providers, the Mayor's Office convened a working group of City departments and nonprofit leadership to explore issues of sustainability and accountability.

With new federal guidelines and given that nonprofits and City departments were still grappling with some of the same issues from 2010, the working group recommended the Controller's Office again work to develop consistent guidance on the treatment of direct and indirect cost items in City contracts and grants.

METHODOLOGY AND KEY FINDINGS

Indirect costs are those that have been incurred for common or joint objectives and cannot be readily identified with a particular final cost objective.¹ Simply stated, they are organizational costs that cannot be isolated to an individual program or contract.

To assess how such costs should be treated in City contracts and grants, the Controller's Office gathered policies and interviewed staff from six City departments.² Additionally, the Controller's Office surveyed seven nonprofit contractors in fall 2017 and conducted follow up interviews with three of the nonprofit contractors in January 2018. Through these activities, the Controller's Office concluded the following:

- 1. There is no standard Citywide guidance on what departments consider direct and indirect costs, and what expenses are allowed or unallowable within those cost categories.**

Contractors and City department staff report that cost allocation and the process for defining direct and indirect costs for a funded program is confusing, time-consuming, and inconsistent across City departments.

While there is no standard Citywide guidance on what departments consider direct and indirect costs and what expenses are allowed and unallowable within those cost categories, a review of existing department policies shows general alignment. For example, departments follow the OMB Uniform Guidance and City policies, when they exist, on how expenses should be categorized. For General Fund grants, City departments tend to follow department-specific guidance and institutional practice, and may use internally-developed guidelines such as DCYF's budget guidance for nonprofits, *Doing Business with DCYF: A Guide to Fiscal Policies, Grant Agreements, and More*.

Despite this, nonprofits report that their City funders may interpret policies and definitions differently or have different policies in place and/or additional rules.

A particular area of variation in department policies arises when considering occupancy expenditures. Department practices vary on funding mortgage, mortgage interest fees, depreciation, and capital costs for real property used in City-funded programming.

- 2. Some contractors may have a difficult time distinguishing between indirect and shared costs in their budgeting for City contracts and grants.**

Nonprofits surveyed generally understand what costs should be treated as indirect, such as finance director salaries and audit costs. However, survey responses showed some variation in how nonprofits categorize their costs, which could indicate a need for more guidance. For example, just five of seven respondents indicate that they consider accounting, payroll, bookkeeping, and human resources staff in their indirect cost category, leaving 28% who may be treating these costs differently in their budgeting process.

¹ Office of Management and Budget. (2004, May 10). Circular A-122. Retrieved from https://www.whitehouse.gov/sites/whitehouse.gov/files/omb/circulars/A122/a122_2004.pdf

² Human Services Agency (HSA), Department of Public Health (DPH), Mayor's Office of Housing and Community Development (MOHCD), First 5, Department of Children, Youth and Their Families (DCYF), and Office of Economic and Workforce Development (OEWD).

GUIDELINES

City departments should adopt the appended budget matrix as standard Citywide guidance for the general treatment of costs in nonprofit contracts and grants.

1. Description:

- The Controller's Office developed a consolidated budget matrix to foster common understanding and transparency on the treatment and allowability of direct and indirect costs in nonprofit contracts and grants. See Appendix A for the matrix and additional cost guidance associated with specific line items.
- The matrix is a guidance document that addresses the most common costs, though it is not inclusive of all possible costs or their treatment. Some discretion may be necessary to allow nonprofits the ability to budget based on programmatic needs.
- Departments administering funds from non-City sources should follow the guidelines associated with those funds.

2. Rationale:

- Standardized guidance will help foster a shared understanding among City departments and nonprofits about the appropriate treatment of costs.
- Alignment on issues of allowability will ease the burden on nonprofits struggling to accurately account for costs across diverging City grants.
- The matrix standardizes the treatment of certain costs that have had varying treatment by departments, such as mortgage, depreciation and capital expenditures.

3. Process:

- The Controller's Office will manage the matrix, and serve as a resource as issues of interpretation arise. These guidelines will be published centrally on the Controller's Office's website, and the guidelines will be reflected in the Accounting Operations and Systems Division's Accounting Policies and Procedures manual.
- Departments should ensure that internal policies related to the treatment of costs in nonprofit contracts and grants aligns with this standardized guidance.
- Departments should ensure that contracts and grants entered into subsequent to the publication of these guidelines follow the cost guidance, as appropriate.³
- Departments may maintain existing templates for grant and contract budgets to the extent that they align with these principles.

4. For Additional Consideration:

- The matrix is a starting point, but requires training for City staff and nonprofits alike to have a shared understanding of the guidelines and its application. The

³ As noted, it is not possible to specify the treatment of costs in every situation.

Controller's Office offers training to nonprofits and City staff annually on issues of budget development and cost allocation procedures through the Citywide Nonprofit Monitoring and Capacity Building Program.

CHANGES FROM VERSION 1.1 (6/26/18):

The Guidelines for Cost Categorization in Nonprofit Contracts and Grants may need updates as new questions about the guidance are raised. As needed, the Guidelines will be updated on an annual basis in January. The Controller's Office will accept questions and submissions for updates through November of each year to be included in the subsequent January release.

Direct Costs

- Food and Events: sugar-sweetened beverages and bottled water added as unallowable.

Indirect Costs

- Salaries/Fringe Benefits: Staff time spent preparing proposals for federal or non-federal grants and contracts added as allowable.

Fundraising

- General guidance updated as follows:

Fundraising expenses are never allowable in City grants or contracts unless the program objective for the City grant is defined as fundraising and/or development capacity building. Departments may offer grants specific to supporting or enhancing nonprofit capacity and in these cases any of the following costs may be allowable as direct program costs. When the program objective is not specific to fundraising activities, fundraising expenses are unallowable per federal guidelines.

Supplemental Guidance

- Depreciation guidance updated as follows:

Depreciation can be a direct cost if the asset/facility is used exclusively for the program. Facility costs can be considered direct costs if they can be directly tied to a cost objective and are deemed reasonable and necessary to carry out a program.

- Subcontracts guidance updated as follows:

Subcontracted services are allowable as direct costs when necessary to support the final cost objective. As such, these direct costs may be used in the calculation of the prime contractor's indirect cost rate with some limitations. The prime contractor can charge indirect costs on the first \$25,000 of each subcontract at the approved/allowed indirect cost rate. Additional subcontract expenses beyond \$25,000 must be excluded from the indirect rate calculation.

APPENDIX A: COST CATEGORIZATION MATRIX

Category	Expense Type	Expense Description	Allowable	Unallowable	Notes
<p><i>Direct program expenses must be approved by the funding department and documented in the grant or contract budget. While costs may be allowable, it does not guarantee funding in a particular cost category. Departments and nonprofits have discretion to negotiate funding for cost items appropriate to the delivery of desired programming. Departments may require additional documentation prior to approving certain costs, and may set a cap on the amount of funding available for certain costs based on funding priorities.</i></p>					
Direct Personnel Expenses	Salaries	Salaries of all program staff, supervisory staff, and support/clerical staff that work directly on programs.	x		
		Bonuses paid to staff.		x	
		Severance payments to former staff.		x	
	Fringe Benefits	Fringe Benefits such as FICA, SUI, health and medical benefits, and retirement benefits.	x		
		Prior fiscal year Fringe Benefits such as vacation, sick, or overtime/compensation time, and taxes or other withholdings related to periods before and after the grant agreement.		x	Unallowable when a nonprofit uses an accrual basis (recommended). If a nonprofit uses a cash basis, the cost of leave is recognized in the period that the leave is taken and paid for, even if earned in the prior year, and this item becomes allowable.
		Lump sum payout of unused vacation or compensatory time		x	When a nonprofit uses accrual-based accounting, the City has already covered the cost of fringe, which then becomes a line in the nonprofit's liability account. If a nonprofit uses a cash basis, payments of unused leave may be allowable as an indirect cost in the year of payment.

Category	Expense Type	Expense Description	Allowable	Unallowable	Notes
Direct Contract Expenses	Stipends	Stipends, including small amounts paid to someone (often a program participant) for engaging in limited periods of work in support of a funded agency or organization. May include AmeriCorps fees.	x		CDBG funds may not be used for stipends (not allowable). Stipends over threshold amount may be considered salaries.
	Contractual Services	Contractual Services provided to program participants or agency by consultants, independent contractors, or other entities that are non-staff individuals. Professionals provide highly technical or specialized services to the agency or program.	x		Contractual Services may require a supplemental approval process prior to placing costs into the grant budget and the contractor must comply with City standards for subcontract oversight and monitoring.
		Contractual services done by the subcontractor's subcontractor.			x
Direct Non-Personnel Expenses	Materials and Supplies	Materials and supplies used in the operation of the program and consistent with the type of services provided by the program. Includes project supplies, office supplies, and postage.	x		
	Facilities/ Occupancy	Facilities or occupancy costs associated with building space, rental/lease of space used to run the program, rent for main space and auxiliary space, and costs associated with facility upkeep and maintenance, including janitorial services.	x		
		Facilities or occupancy costs such as property taxes, loans against own property, and security deposits.			x
	Utilities	Percentage allocation of utilities, such as gas, electric, and water bill, used by each program.	x		

Category	Expense Type	Expense Description	Allowable	Unallowable	Notes
	Equipment	Equipment purchase, lease, and maintenance costs that directly benefit program participants. Includes computers, IT systems, furniture, ongoing or one-time lease, printers, and photocopying equipment. Includes direct costs or percentage allocation of shared equipment used by each program.	x		
		Depreciation on purchased equipment.	x		Certain federal funding sources may restrict use of funding on these costs. Costs must be approved by the awarding department. See Supplemental Guidance for details.
	Transportation/Travel	Transportation and travel costs used for the program. Includes local transportation, out-of-town travel for program purposes, and field work. Includes mileage, vehicle rental, tolls, gas, parking fees, air travel, and ground transportation if staff are required to travel to perform scope of funded services.	x		Out-of-area travel may require a supplemental approval process prior to placing costs into the grant budget.
		Vehicle purchase (and related costs) as required to perform scope of funded services	x		Most departments require a pre-approval process prior to placing vehicle purchase into the grant budget.
		Parking/moving violations.		x	
	Training	Staff development costs used to pay registration or attendance fees for staff to attend workshops or trainings aimed to build capacity for the program. Staff development costs such as out-of-town conference transportation, lodging, food or per diem for staff.	x		Training costs and travel associated with staff development may require a supplemental approval process prior to placing costs into the grant budget.

Category	Expense Type	Expense Description	Allowable	Unallowable	Notes
	Events and Food	Events and field trip costs related to the program. Includes vehicle rentals for participants, transportation for participants, food/meals for participants, and costs of permits needed for events.	x		CDBG funds may not be used for food or entertainment for participants (not allowable).
		Alcoholic beverages, sugar-sweetened beverages, bottled water, and tips/gratuity.		x	
	Incentives	Incentives for program participants. Includes gift cards, honoraria, and award for participants, speakers, and volunteers.	x		CDBG funds may not be used for incentives (not allowable).
	Insurance	Insurance fees for required insurance policy maintenance costs such as commercial general liability, auto, workers compensation, and event insurance. Includes direct allocation of program-specific policies or percentage allocation of applicable agency-wide insurance costs.	x		
	Tele-communications	Telecommunications costs used for the program. Includes telephone, fax, internet, and cell phones used for programmatic purposes.	x		
	Capital and Mortgage	Capital costs for real property necessary for the delivery of programs.	x		Certain federal funding sources may restrict use of funding on these costs. See Supplemental Guidance for details.
		Mortgage Principal.			x
	Mortgage interest fees on real property used in the delivery of programs.	x			Certain federal funding sources may restrict use of funding on these costs. See Supplemental Guidance for details.

Category	Expense Type	Expense Description	Allowable	Unallowable	Notes
		Mortgage interest attributable to fully depreciated assets.		x	
	Miscellaneous	Professional licenses for staff, if required for program.	x		
		Job posting and finger-printing of staff, if required for program.	x		
<i>At departmental discretion, indirect costs may be capped. If an agency has a federally-approved indirect cost rate, departments will use this rate for federally-funded grants, but may not use that rate in General Fund grants.</i>					
Administrative/ Indirect Expenses	Salaries/ Fringe Benefits	Direct or percentage allocation of Executive Director salary and benefits for time spent in administrative activities (e.g., per functional time sheet or time survey).	x		
		Chief financial officer salary and benefits.	x		
		Contract administration and compliance staff salaries and benefits.	x		
		Other administrative staff salaries.	x		
		Accounting services and bookkeeping.	x		
		Payroll fees and other HR expenses.	x		
		Information technology staff salaries.	x		
		Staff time spent preparing proposals for federal or non-federal grants and contracts.	x		
	Contractual Services	Audit fee.	x		
		Fiscal agent fee.	x		Departments may have caps on the maximum amount of fiscal agent fees that can be included in the budget.

Category	Expense Type	Expense Description	Allowable	Unallowable	Notes
		Administrative IT system costs (e.g., QuickBooks).	x		
		Website design, maintenance, or hosting services.	x		
	Materials and Supplies	Office supplies or percentage allocation of office supplies used by administrative staff.	x		
		Materials and supplies associated with board meetings.	x		
	Facilities/Utilities	Percentage allocation of rent and utilities used by administrative staff.	x		
		Depreciation on real property	x		See Supplemental Guidance for details.
	Equipment	Percentage allocation of equipment used by administrative staff; depreciation on purchased equipment.	x		
	Transportation/Travel	Transportation expenses incurred by administrative staff.	x		
	Insurance	Percentage allocation of insurance fees for required insurance policy maintenance costs such as commercial general liability, auto, workers compensation, and event insurance.	x		
		Directors and Officers insurance fees.	x		

Category	Expense Type	Expense Description	Allowable	Unallowable	Notes
	Training	Staff development costs used to pay registration or attendance fees for staff to attend workshops or trainings aimed to build capacity for the agency overall (e.g., attended by finance or HR staff).	x		
	Events	Agency-wide events without specific program benefit (e.g., open house). Events and field trip costs for events that only benefit staff members, such as staff recognitions, celebrations, events attended by staff only, food for staff, and staff meals at restaurants.	x		
	Tele-communications	Percentage allocation of telecommunications costs for administrative staff.	x		
	Miscellaneous	Nominal bank charges such as those required for maintaining a checking account.	x		
		Bank fees such as interest, late/penalty fees, non-sufficient service fee/overdraft fees, cash advance fee, foreign exchange fees, and credit card fees.		x	
		Personal costs.		x	
		Religious workshops, instruction or proselytization.		x	
	Bad debts including losses and related collection and legal costs.		x		
	Political activities.		x		

Category	Expense Type	Expense Description	Allowable	Unallowable	Notes
<i>Fundraising expenses are never allowable in City grants or contracts unless the program objective for the City grant is defined as fundraising and/or development capacity building. Departments may offer grants specific to supporting or enhancing nonprofit capacity and in these cases any of the following costs may be allowable as direct program costs. When the program objective is not specific to fundraising activities, fundraising expenses are unallowable per federal guidelines.</i>					
Fundraising Expenses	Salaries/ Fringe Benefits	Development Director or other staff with fundraising as a primary job role.		x	
		Direct or percentage allocation of Executive Director salary and benefits for time spent in fundraising activities (e.g., per functional time sheet or time survey).		x	
	Contractual Services	Fundraising consultant fees.		x	
	Materials and Supplies	Office supplies (including postage) or percentage allocation of office supplies used by fundraising staff.		x	
	Facilities/Utilities	Percentage allocation of rent and utilities used by fundraising staff.		x	
		Space rental for fundraising events.		x	
	Equipment	Percentage allocation of equipment used by fundraising staff.		x	
	Transportation/ Travel	Transportation expenses incurred by fundraising staff.		x	
	Insurance	Percentage allocation of insurance fees for required insurance policy maintenance costs such as commercial general liability, auto, workers compensation, and event insurance.		x	
	Training	Staff development costs used to pay registration or attendance fees for staff to attend workshops or trainings aimed to build capacity for fundraising.		x	
	Events	Fundraising event costs.		x	
Tele-communications	Percentage allocation of telecommunications costs for fundraising staff.		x		

SUPPLEMENTAL GUIDANCE ABOUT THE TREATMENT OF COSTS

For full text of the Office of Management and Budget (OMB) Uniform Guidance, visit:
<https://www.ecfr.gov/cgi-bin/text-idx?SID=0d3c684a605f5b420152ed1a47e415da&mc=true&node=pt2.1.200&rgn=div5>

Capital Expenditures

Allowable Direct Cost.

Capital expenses, including capital improvements, are allowable unless prohibited by City Charter or a federal awarding agency.

OMB states that certain capital expenditures for general purpose land, buildings or equipment are unallowable except when approved in advance by the awarding agency. In such cases where federal funds are awarded to nonprofit service providers and the awarding agency has not explicitly allowed the use of these funds for general purpose capital expenditures, these costs are unallowable.

City Charter prohibits the use of Children's Fund for capital expenditures. The Department of Children, Youth and Their Families includes all associated costs, including mortgage interest costs and depreciation, in this prohibition.

For General Fund contracts and grants, and federally-funded contracts and grants where such costs have been explicitly allowed by the awarding agency, the costs are only allowable with pre-approval by the department. Departments may set funding caps, and may require justification and other documentation prior to confirming costs in the grant or contract budget. Allowability does not guarantee funding for capital expenditures. Departments may make choices about the budget items they prioritize for funding.

Capital expenditures must always be considered direct costs. If the building is used by multiple programs, the costs should be allocated using a reasonable methodology.

Reference: OMB Uniform Guidance Part 200 Subpart E Section 200.439 Equipment and Other Capital Expenditures.

Mortgage Principal

Not Allowable.

Principal mortgage costs are not allowable in City contracts or grants. Instead, the cost of the principal can be recovered through depreciation (see below).

Reference: OMB Uniform Guidance Part 200 Subpart E Section 200.436 Depreciation.

Mortgage Interest Fees

Allowable Direct Cost.

With certain restrictions, mortgage interest fees are allowable in City contracts and grants with nonprofits. To be considered allowable, the contract and/or grant must explicitly state this type of expense will be included in the budget and is allowable.

The cost of mortgage interest fees must also be reasonable, meaning they are ordinary, necessary, and in line with fair market value for comparable space. To be considered reasonable, grantees and contractors must demonstrate that the expense being charged to the City aligns with fair market value by providing quotes or similar cost-per-square-foot estimates for three comparable spaces. Departments should verify fair market value prior to budget approval, and may re-verify annually. If the mortgage interest expense exceeds fair market value, departments must cap allowable payments at fair market value to conform to the reasonable standard.

Mortgage interest fees are always direct program costs. If the building is used by multiple programs, the costs should be proportionally allocated to programs, administrative and fundraising cost centers according to actual usage by each cost center. Departments may request additional documentation necessary to verify the proportional share of space used for funded programs, or to verify fair market value of space.

For facilities acquisitions (excluding renovations and alterations) costing over \$10 million where the Federal government's reimbursement is expected to equal or exceed 40% of an asset's cost, the nonprofit organization must prepare, prior to the acquisition or replacement of the capital asset(s), a justification that demonstrates the need for the facility in the conduct of federally-sponsored activities. Upon request, the needs justification must be provided to the Federal agency with cost cognizance authority as a prerequisite to the continued allowability of interest on debt and depreciation related to the facility.

Mortgage interest fees are unallowable in the following circumstances:

- Interest associated with subsequent loans against property for uses other than occupancy (i.e., a second mortgage) is unallowable.
- Interest attributable to a fully depreciated asset is unallowable.
- Interest in connection with acquisitions of capital assets that occurred prior to September 29, 1995 is unallowable.

Reference: OMB Uniform Guidance Part 200 Subpart E Section 200.449 Interest.

Depreciation

Allowable Indirect Cost.

Depreciation, both for real property and for equipment of over \$5,000 per unit, is an allowable cost. Depreciation is an indirect expense, which may be allocated to programs using a consistent and reasonable methodology.

To approve inclusion of depreciation in a nonprofit contract or grant budget, City departments should review a depreciation schedule provided by the nonprofit. Charges for depreciation must be supported by adequate property records, and physical inventories must be taken at least once every two years to ensure that the assets exist and are usable, used, and needed. In addition, adequate depreciation records showing the amount of depreciation taken each period must also be maintained.

Any portion of the property purchased using either federal or City General Fund dollars must be excluded from depreciation schedule. For example, if the City provides \$500,000 in capital investment for a \$1,000,000 building, the depreciation schedule should exclude the \$500,000 in City-funded capital. Nonprofits must note when City or federal sources funded any portion of capital costs for property.

Per Federal guidelines, a cost may not be treated as a direct cost if any other cost incurred for the same purpose, in like circumstance, has been allocated as an indirect cost. However, there may be circumstances where indirect costs like depreciation may be allowable as direct costs. Such special circumstances must be evaluated on a case-by-case basis. Items generally designated as indirect costs may be treated as direct costs if incurred for different purpose or in unlike circumstances. These costs may be charged directly when:

- The cost can be accurately identified with the specific cost objective;
- The cost is required by the scope of the project;
- The specific type and nature of the cost is significantly greater than ordinarily required by a sponsored project; and
- The cost is clearly disclosed and fully justified in the proposal budget and approved by the City in the grant or contract.

Reference: OMB Uniform Guidance Part 200 Subpart E Section 200.436 Depreciation.

Subcontracts

Allowable Direct Cost.

Subcontracted services are allowable as direct costs when necessary to support the final cost objective. As such, these direct costs may be used in the calculation of the prime contractor's indirect cost rate with some limitations. The prime contractor can charge indirect costs on the first \$25,000 of each subcontract at the approved/allowed indirect cost rate. Additional subcontract expenses beyond \$25,000 must be excluded from the indirect rate calculation.

Reference: OMB Uniform Guidance Part 200 Subpart A Section 200.68 Modified Total Direct Cost (MTDC)