

F ood & N utrition S ervice	FNS INSTRUCTION	NUMBER
	U.S. DEPARTMENT OF AGRICULTURE 3101 PARK CENTER DRIVE ALEXANDRIA, VA 22302-1500	796-2 Rev. 4

ACTION BY: Regional Directors
Special Nutrition Programs

INFORMATION FOR: Regional Offices
State Agencies

**FINANCIAL MANAGEMENT -
CHILD AND ADULT CARE FOOD PROGRAM**

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- B Food Cost
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- H Suggested Format for an Inventory Record
- I. Costs Requiring Additional Approvals
- J. Questions and Answers

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CHILD AND ADULT CARE FOOD PROGRAM

I PURPOSE

CACFP funds are provided to assist State agencies through grants and other means to initiate and maintain nonprofit food service Programs for eligible children and adult participants in nonresidential institutions that provide care. This Instruction establishes Program standards, principles and guidelines for financial management to:

A Assure that costs charged to the nonprofit food service are for food service provided principally to enrolled, eligible participants; and where applicable, that costs claimed for reimbursement under the CACFP are necessary and reasonable for effective and efficient operation of the nonprofit food service, and are otherwise allowable under the Federal cost principles and this Instruction;

B Provide financial management guidance to State agencies pursuant to 7 CFR §226.7(m) for CACFP financial management systems;

C Provide guidance to institutions in developing the financial information needed to comply with the requirements of the CACFP; and

D Provide guidance so that to the extent practicable, all institutions of similar type doing the same work will be subject to the same requirements.

II AUTHORITY

The CACFP is authorized by Section 17 of the Richard B. Russell National School Lunch Act, as amended. Program regulations issued by the Department are found in [7 CFR Part 226](#). USDA codifications of government-wide pronouncements include:

A The uniform requirements for the administration of grants are found in:

- 1 7 CFR Part 3015, Uniform Federal Assistance Regulations;
- 2 7 CFR Part 3016, [Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments](#); and
- 3 7 CFR Part 3019, [Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals, and Other Nonprofit Organizations](#).

B The principles for determining applicable costs and factors affecting their allocation to grant Programs are provided in:

- 1 2 CFR Part 225, [Cost Principles for State, Local, and Indian Tribal Governments \(formerly OMB Circular A-87\)](#);
- 2 2 CFR Part 230, [Cost Principles for Nonprofit Organizations \(formerly OMB Circular A-122\)](#); and
- 3 48 CFR Part 31, [Contract Cost Principles and Procedures](#).

C Audit requirements are contained in OMB Circular A-133, codified by USDA at 7 CFR Part 3052, [Audits of States, Local Governments and Nonprofit Organizations](#).

D National Policy requirements are contained in the following pronouncements:

- 1 [2 CFR Part 180 as adopted and modified by USDA regulations at 2 CFR Part 417](#) Government-wide Debarment and Suspension (Non-procurement);
- 2 7 CFR Part 3018, [New Restrictions on Lobbying](#);

E Requirements on records to be kept by employers are found at [29 CFR Part 516](#).

III ABBREVIATIONS

ADP - Automated Data Processing
CACFP - Child and Adult Care Food Program
CFR - Code of Federal Regulations
EFT - Electronic Funds Transfer

FAR - Federal Acquisition Regulations (48 CFR Part 31)
DCH – Day care home
FLSA - Fair Labor Standards Act (codified at 29 CFR Part 516)
FNS - Food and Nutrition Service
FNSRO - Food and Nutrition Service Regional Office
FSMC - Food Service Management Company
GSA - General Services Administration
IRS - Internal Revenue Service
OMB - Office of Management and Budget
SA – State agency
SEA – State Education Agency
U.S. - United States
U.S. GAAP – Accounting Principles Generally Accepted in the United States of America
USDA - United States Department of Agriculture

IV SCOPE

This Instruction represents one of the requisite elements that must be used by the State agency in establishing the financial management system required by the Program regulations (7 CFR §226.7(m)) to identify allowable Program costs and establish standards for institutional recordkeeping and reporting. State agencies are further required to provide guidance on financial management requirements to each institution (Ibid.) and each institution is required to maintain records demonstrating compliance with the State agency’s financial management requirements (7 CFR §226.15(e)(6)). State agencies may either (a) designate the use of this Instruction, or (b) incorporate this Instruction into the State agency’s financial management system.

The provisions of this Instruction apply to all CACFP institutions, including public and private nonprofit sponsoring organizations, as well as, eligible child and adult care centers.

V DEFINITIONS

Exhibit A, attached, contains a glossary of terms that are frequently used in this Instruction.

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VI MONITORING NONPROFIT FOOD SERVICE STATUS

All participating institutions must operate a nonprofit food service principally for the benefit of enrolled participants and maintain records documenting the operation of that food service. Nonprofit food service includes all food service operations conducted by the institution principally for the benefit of enrolled participants, from which all of the Program reimbursement funds are used solely for the operation or improvement of that food service. Food service account activity must be monitored to determine nonprofit food service status for institutions. Independent centers, sponsors of day care homes and sponsors of centers must meet this requirement. While day care homes are exempt from maintaining a nonprofit food service, sponsors of centers need to ensure their centers maintain a non-profit food service. State agencies are required to conduct reviews of participating institutions to ensure these requirements are met.

A Public and Private Nonprofit Institutions Not Excluded. The institution's status as public or private nonprofit cannot be used by the institution or the State agency as evidence that the institution is operating a nonprofit food service.

B Cost Based Reimbursement Not Excluded. Earning reimbursement on the lesser of meals times rates or costs cannot be used by the institution or the State agency as evidence that the institution is operating a nonprofit food service.

C Determining Nonprofit Food Service Status. Nonprofit status does not require that the institutions operate at a break-even or loss. Nonprofit status is determined by the scope of the food service activities conducted by the institution and the use of nonprofit food service revenues.

1 All Food Service Activities Included. When the only food service conducted by the institution is for the benefit of its own enrolled participants, the entire food service is included as part of the institution's nonprofit food service and no separation between Program and non-Program operations and costs is required. Cost allocation for the occasional use - purposes, such as bake sales, parent-child dinners and non-Program staff meals is not necessary unless the State agency determines such non-Program activities are material. It is always necessary to allocate the use of food and other expendable resources. It is impermissible to pay for non-Program uses of expendable resources with Program funds.

2 Excluded Food Service Activities. There are situations when an institution does not conduct the food service principally for the benefit of its own enrolled participants. For example, an institution may operate primarily as a food service management company; i.e., its CACFP component may only be an adjunct to other food service operations or the institution may not operate the actual food service for participants. An example of the latter is when the institution is a sponsor of day care homes or centers. In addition, an institution may operate both Program and non-Program centers.

(VI C 2)

When an institution does not operate the food service for its own enrolled participants or when its total food service is not conducted principally for the benefit of its own enrolled participants, the non-Program and Program components of the food service operation must be segregated. Through this separation, the institution must ensure that the nonprofit food service Program component does not support any non-Program food service activities.

Unallowable support occurs when non-Program costs are assigned to the nonprofit food service or when Program revenues are not used for allowable food service expenses or not retained in the nonprofit food service account.

The institution must maintain accounting records documenting proper cost allocation between the Program and non-Program components of its food service operation and the State agency must ensure through the review process that all CACFP reimbursements are used solely for conducting nonprofit food service operations. The cost of nonprofit food service operations includes both operational costs and administrative costs incurred by sponsoring organizations. Administrative costs are supported by administrative funds provided to sponsors of day care homes and up to 15 percent of the reimbursement total for administrative costs for sponsors of centers. See paragraph VII D 1, below for more information.

A sponsoring organization may also serve as a vendor and vend meals to both CACFP and non-CACFP sites. In this situation, the sponsoring organization would have to separate and properly allocate the administrative costs and revenues associated with vending meals to CACFP sites and vending meals to non-CACFP sites.

3 Income to the Program. All income to the Program must be retained and used in the institution's nonprofit food service account. (See item IX D 6, below and Exhibit J for more information on income to the Program).

4 Review Elements. Nonprofit status is determined through:

a Identifying all nonprofit food service revenues, including;

(1) CACFP reimbursements;

(2) Income to the Program; and

(3) All other funds used or restricted for use in the nonprofit food service Program. These other funds may consist of donations identified for the nonprofit food service Program and nondiscretionary funds of the institution that must be committed to the nonprofit food service Program.

(VI C 4)

b Including only allowable net expenses incurred in the operation or improvement of the nonprofit food service Program when determining food service costs;

(VI C)

c Deducting allowable net expenses (identified in b, above) from total nonprofit food service revenue (identified in a, above);

d Identifying the excess of all nonprofit food service revenues over nonprofit food service expenses; and

e Verifying that any excess of revenues over expenses is retained and used only in the nonprofit food service Program.

D Excessive Nonprofit Food Service Account Balances. Each State agency must determine what constitutes an excessive nonprofit food service Program balance and the corrective actions an institution must take to reduce an excess balance.

1 The State agency cannot reduce future reimbursement payments or recover food service funds as a means of reducing excess balances, but rather must ensure institutions reduce excess food service account balances through improvements or expansion of the nonprofit food service for Program participants.

2 Although it is highly encouraged to use excess funds to either improve or expand the nonprofit food service for the benefit of Program participants, excess funds may also be used for any allowable costs related to other Child Nutrition Programs operated by the institution. However, the institution cannot transfer the excess funds to non-Program operations.

3 With specific prior written approval from the State agency, an institution may use excess funds for increases in salaries or fringe benefit costs to improve food service operations, principally for the benefit of the participants. Specifically, this flexibility is extended to an institution improving its services and raising the professional standards, educational levels, and skill sets of its staff. In determining the reasonableness of an institution upgrading its compensation scale, the State agency should consider such factors as compensation scales of comparable organizations within the proximity of the institution's geographical location.

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VII BASIC GUIDELINES FOR DETERMINING ALLOWABILITY OF COSTS

This section provides the general requirements for determining allowable costs.

Paragraph A contains general criteria; Paragraphs B and C provide guidance on cost allocation and indirect and direct costs, respectively; while paragraph D contains the criteria used to identify administrative and operating costs.

Only allowable costs
may be charged to
the CACFP
nonprofit food
service account.

A General Criteria. Institutions must account for all costs of operation through the consistent use of U.S. generally accepted accounting principles (U.S. GAAP). Some of these costs will be allowable operating or administrative costs of the Program while others will be unallowable. These unallowable costs may be necessary and reasonable for operation of the institution but are not allowed as Program costs, even when the preponderance of the institution's revenue is from the CACFP.

1 Actual Cost. The cost must be a bona fide operating or administrative expense incurred in conducting the Program.

a Budgets. For budgeting purposes, the value of a bona fide operating or administrative expense may be estimated when actual data is not available.

b Final monthly claims. Estimated costs cannot be included on the institution's final monthly claim for reimbursement.

2 Cash or Accrual Accounting. Costs may be reported on an accrual basis (expenses and income recorded when incurred); a cash basis (expenses and income reported when paid/received) or a modified accrual basis (certain expenses and income are reported on a cash basis while other costs and expenses are reported on an accrual basis); however, the institution's accounting system must treat all costs consistently.

a Final claim-accrual accounting required. When reimbursement is paid on the lesser of rates or cost, the institution's final claim for reimbursement for the fiscal year must reflect costs on an accrual basis. Institutions using cash based accounting must make all necessary accounting adjustments to report accrued costs and income on the final claim for the fiscal year. These institutions must also take appropriate precautions to ensure that accrued costs and income reported on the final claim are not reported again in a future period.

3 Allowability. Costs must meet the following factors:

a Necessary. The cost must represent an activity or function that is generally recognized as reasonable and necessary for the operation of the Program. The cost must be essential to fulfill regulatory requirements for proper and efficient administration of the Program.

(VII A 3 a)

To determine if a cost is necessary, the State agency must consider if it is needed for the operation of the Program. Is this cost item needed to fulfill proper administration of the Program?

Some costs are allowable but the entire amount of the cost item may not be reasonable to fulfill proper and efficient administration of the Program. Costs such as reasonable and necessary salary amounts, salary increases, salary benefits such as gym memberships, and computer equipment are allowable costs.

The State agency should establish policy that is consistent with the cost and Program regulations regarding what cost items require additional information to approve the cost. For example, salary raise thresholds, salary levels over Bureau of Labor Statistics, vehicles, etc.

b Reasonable. The type and amount of cost must not exceed what a prudent person would pay under the same circumstances. Factors that are used to determine reasonableness include:

(1) The restraints imposed by generally accepted sound business practices;

(2) Arms-length bargaining;

(3) Federal and State laws and regulations;

(4) Whether the individuals acted with prudence considering their responsibilities to the organization, its members, employees, and clients, the public at large, the Federal Government and the CACFP; and

(5) Whether there are significant deviations from established practices which may unjustifiably increase costs.

c Authorized. The cost must be authorized or at least not prohibited under Federal, State or local laws, regulations and this Instruction.

d Limitations. The cost must conform to any limitations or exclusions set forth in this Instruction, Federal, State or local laws or regulations as to types or amounts of cost items.

e Current. The cost must not be assignable or included as a cost to a prior or future period.

(VII A 3)

f Multiple Awards. The cost must not be assignable or included as a cost to any other current or prior Federally-financed Program. See item IX D 5, below.

g Consistent treatment. The cost must be treated consistently through the application of U.S. GAAP.

h Net cost. The cost must be net of all applicable credits.

i Allocated. The cost must be properly allocated so that only the allowable share of the cost is assigned to the Program.

j Documented. Costs must be supported by documentation that adequately demonstrates that the costs:

(1) Have been incurred;

(2) Are Program costs; and

(3) Comply with all applicable laws, regulations and

this Instruction.

4 Unallowable costs. Costs may be expressly unallowable, directly associated with expressly unallowable costs, or may be unallowable through the actions or inactions of the institution. No portion of an unallowable cost may be charged to the Program, but an unallowable cost must be assigned its fair share of indirect costs. The following also apply:

a Expressly unallowable costs are costs made unallowable by this Instruction, applicable laws and regulations.

b Directly associated unallowable costs are the costs that result from the institution incurring an expressly unallowable cost, such as the costs of supplies used by an institution engaging in prohibited lobbying activities.

c Costs made unallowable by the action or inaction of the institution include costs that would otherwise be allowable, for example administrative labor costs that become unallowable because the institution failed to maintain the required documentation to support the costs charged to the Program.

B Allocation of Costs. Some costs benefit more than one objective or activity. Only the share of the costs that benefit the Program can be assigned as Program costs. A variety of methods are available to allocate these costs. Refer to paragraph C, below, for additional information.

(VII)

C Direct and Indirect Costs. Allowable costs can be either direct or indirect. Because of the diverse nature and accounting practices of institutions, it is not possible to identify which specific costs will be classified as direct or indirect.

1 Direct Costs. Direct costs can be administrative or operating expenses or a combination of the two that benefit the institution's nonprofit food service.

a Examples of direct costs include:

(1) Operating and administrative nonprofit food service employee salaries;

(2) Depreciation or use allowances on equipment used in the nonprofit food service Program; and

(3) Food purchased for use in the nonprofit food service Program.

b Allocated direct costs. When the benefits of a direct cost cannot be specifically identified as an operating or administrative cost, or the direct cost benefits both allowable and unallowable activities, or the cost benefits more than one State for multi-State institutions, this shared cost must be allocated. The State agency must provide the institution with specific prior written approval of the method that the institution will use to allocate the cost. The method used must allocate the cost based on the benefits received, not the source of funds available to pay for the cost.

2 Indirect Costs. For the purposes of this Instruction, indirect costs are those that have been incurred for common or joint objectives but cannot be readily identified or assigned to the food service, CACFP, other institution activities or a component (administrative versus operating) of the Program.

a Examples of common indirect costs are:

(1) Depreciation and use allowances on buildings and equipment used for common or joint objectives;

(2) Costs of operating and maintaining facilities;

(3) Salary of the receptionist; or

The full cost of the CACFP includes both direct and indirect costs. Direct costs can be readily identified to the CACFP and indirect costs are incurred for the benefit of multiple Programs. Indirect costs can only be charged to the CACFP through the SEA's allocation process.

(VII C 2 a)

(4) Salaries of the central accounting staff.

b Indirect costs must be allocated on a consistent and rational basis in accordance with the State agency's financial management system and are subject to review by FNS. An institution cannot use an indirect cost rate to assign costs to the Program unless the rate has been developed through a cost allocation plan approved by the cognizant Federal or State agency.

(1) The institution must use 2 CFR Part 225, *Cost Principles for State, Local, and Indian Tribal Governments*; 2 CFR Part 230, *Cost Principles for Nonprofit Organizations*; and 48 CFR Part 31, *Contract Cost Principles and Procedures*, as applicable, when developing a cost allocation plan. An institution should contact its State education agency for additional guidance.

D Operating and Administrative Costs. These costs include both direct and indirect costs.

1 Operating costs are limited to the institution's allowable expenses of serving meals to eligible participants in eligible child and adult care centers. Except as provided in §226.18(a), sponsors of day care homes do not have allowable operating expenses.

a Examples of operating costs for institutions are:

- (1) Food;
- (2) Food service labor;
- (3) Nonfood supplies; and
- (4) Food service equipment.

2 Administrative costs are limited to the institution's allowable expenses for planning, organizing and managing a Program.

a Examples of administrative costs include salaries, wages, fringe benefits, etc. to accomplish the following:

(1) Reviewing and submitting facility applications to the State agency for Program participation approval;

(2) Reviewing and approving income eligibility statements;

(VII D 2 a)

- (3) Providing nutrition education to food service staff;
- (4) Providing Program training for institution staff and facilities; and
- (5) Conducting CACFP monitoring and training visits to sponsored facilities.

VIII STANDARDS FOR ALLOWABLE COSTS

Allowable costs are bona fide obligations of the institution incurred for the actual expenses of operating the Program which are liquidated timely. Certain costs may be allowable for a public institution but unallowable for a private nonprofit institution and vice versa. Furthermore, subsequent events may result in the reclassification of costs from allowable to unallowable. In all cases, allowable costs require some level of State agency approval. For quick reference, Exhibit C is an index that provides the page number for some of the costs and financial management subjects included in this Instruction.

A Cost Principles. Institutions are responsible for accounting for costs correctly and for maintaining records and sufficient supporting documentation to demonstrate that costs claimed have been incurred, are allocable to the Program, and comply with State agency financial management requirements, this Instruction, and applicable Program regulations and policies. Costs that are not properly documented and recorded pursuant to U.S. GAAP, State agency financial management requirements, 7 CFR Part 226 and other applicable regulations, 2 CFR Part 225 or 2 CFR Part 230, as applicable, and this Instruction are unallowable.

B Disclosure. Certain costs contained in this section require greater disclosure than others. State agencies are required to provide guidance to institutions on the disclosure requirements of this Instruction and how institutions can satisfy those requirements. Institutions are required to meet the State agency disclosure requirements and provide any additional information needed for the State agency to make an informed decision on the allowability of the institution's budgeted or claimed costs.

The failure of the institution to identify related party transactions, less-than-arms-length transactions, ownership interests in equipment, supplies, vehicles and facilities or disclose any other information to the State agency that inhibits the State agency's ability to make an informed assessment of the allowability of a particular cost will result in the disallowance of the cost and may subject the institution, its principals, employees, consultants or others to the administrative and legal remedies available to the State agency and FNS. If the State agency determines that the institution's failure to disclose pertinent information was not deliberate, the State agency may permit the institution to claim and retain CACFP reimbursement up to the amount that would have been allowed had a full and accurate disclosure been provided to the State agency; however the State agency cannot permit the institution to claim unallowable costs, retain Program funds earned as a result of claiming unallowable costs, or use nonprofit food service account funds to pay for unallowable costs.

It is up to the State agency to determine the level of disclosure that is required for individual costs. The State agency may require additional information from institutions to ensure that any particular cost is allowable under this Instruction.

(VIII)

C Special Considerations in Determining Allowability. Certain situations require special consideration when determining whether the amounts and types of expenses are reasonable Program costs. Special consideration is needed whenever a transaction lacks independence (for example, less than arms length transactions), because the integrity of the transaction could be compromised. In cases requiring special consideration, specific prior written approval is always required. The State agency may impose limits on the amount and frequency of costs charged to the Program when special considerations exist. The State agency may also establish additional cases, not inconsistent with this Instruction, that require special consideration.

D Generally Allowable Costs. Generally allowable costs are the customary costs that occur in the routine operation of the CACFP and which are allowed by this Instruction, 2 CFR Part 225, 2 CFR Part 230, 48 CFR Part 31, Federal regulations, FNS and State agency policies, guidance and instructions. While these costs are generally allowable, an institution must disclose them in the administrative budget submitted to the State agency (§226.15(b)) and these costs must still be approved in advance by the State agency through the management plan and budget submission process (§226.6). Approval of the budget results in the approval of the budget line items but is not a guarantee that any particular cost item within a budget line item will be allowed, or that the budget line item will be funded.

Even generally allowable costs must be disclosed to the State agency and approved in advance of expenditure.

E Prior Approval. The phrase “prior approval” is used in this Instruction to identify costs that must be specifically identified by item and amount during the budget submission process to permit the State agency to fulfill the regulatory requirements of §226.6(f), §§226.7(b)(g)(m) and §226.10, as applicable; and to permit the institution to fulfill the regulatory requirements of §226.6(f) and Part 226, Subparts D and E, as applicable. Including the item as part of a larger entry on a line item in the budget without identifying the specific cost item and amount is not sufficient and will not meet the requirement for sufficient disclosure. When these cost items and amounts are properly disclosed, approval of the budget meets the requirement for prior approval unless the State agency specifically disallows the cost in writing. Costs requiring prior approval include costs identified in the 2 CFR Part 225, 2 CFR Part 230, or 48 CFR Part 31 as generally allowable costs, but, due to limitations imposed by CACFP statutory, regulatory and policy considerations, may not be allowable Program costs.

Each cost must be identified by item and amount.

F Specific Prior Written Approval. The phrase “specific prior written approval” is used in this Instruction to identify costs that are not allowed unless the State agency has provided the institution with specific written approval of both the cost and the amount of the cost that can be charged to the Program before the cost is incurred.

(VIII F)

Specific prior written approval by the State agency is required because these costs are not customarily incurred in the routine operation of the CACFP but can sometimes be necessary and reasonable for proper and effective Program operations. Approval of a budget line item does not constitute adequate specific prior written approval for these costs. The institution must specifically identify and request approval of these costs during the annual budget approval process or submit a separate request outside of the annual budget approval process. Whether submitted during the budget approval process or at another time during the year, the State agency must approve or deny these specific requests in writing. The approval of the budget is not an automatic approval of items that require specific prior written approval, unless these items are specifically identified in the budget itself. Costs requiring specific prior written approval may include costs identified in the 2 CFR Part 225, 2 CFR Part 230, or 48 CFR Part 31 as allowable costs, but due to limitations imposed by CACFP statutory, regulatory and policy considerations may not be allowable Program costs.

The State agency determines what steps must be taken before these costs can be charged to the Program.

See Exhibit I “Costs Requiring Additional Approvals” for items requiring prior approval, specific prior written approval, and FNSRO approval.

G Unallowable Costs. Not all expenses will be allowable costs. Unallowable costs cannot be charged to the Program or claimed for reimbursement. The institution’s accounting records must segregate, account for and identify all unallowable costs. Further, unallowable costs must be included in the development of any cost allocation rate proposal and unallowable costs must be attributed a fair and equitable share of the institution’s indirect costs. Institutions must fund unallowable costs from non-Program sources.

H Program Costs. The term "Program" in this Instruction means the institution's food service conducted primarily for the benefit of enrolled participants. When capitalized, the term “Program” refers specifically to the CACFP.

I Selected Items of Cost. The following costs frequently occur in organizations operating the CACFP. These costs include generally allowable costs, costs requiring prior approval, costs requiring specific prior written approval and unallowable costs. For additional information, 2 CFR Part 225 for public institutions; 2 CFR Part 230 for private nonprofit organizations) and 48 CFR Part 31 for proprietary institutions should be consulted.

1 Accounting. Institutions must maintain accounting systems and account for costs in accordance with U.S. GAAP. (See item 24 below for more information regarding “professional services”.)

(VIII I 1)

a Allowable Costs. The cost of establishing and maintaining accounting and other information systems required for the management of the Program.

b Unallowable Costs. Any cost incurred to meet or maintain the institution's incorporation or not-for-profit status.

2 Administrative Appeal Costs. Costs allowed by this section can become unallowable in certain cases. (See item 11, below.) Institutions have a right to appeal certain actions of the State agency (§226.6(k)). The costs of provider appeals are included under Participant Support Costs. (See item 30 a(3), below.)

a Allowable Costs. The institution's costs for administrative appeals pursuant to the CACFP regulations are allowable, including:

(1) Costs for in-house or properly procured private counsel;

(2) Costs for professional services, such as an accountant or consultant, administrative and clerical services; and

(3) Costs of directly related services provided by the institution's employees, officers and trustees not otherwise claimed as labor costs. (See 23, below.)

b Unallowable Costs. Costs for civil, legal or other proceedings are unallowable, including the costs of pursuing a judicial review of a decision rendered by a hearing official pursuant to §226.6(k).

3 Advertising and Public Relations Costs. Advertising media includes newspapers, magazines, radio and television, direct mail, world wide web pages, trade papers, imprinted buttons, pins, banners, and similar goods. Public relations means those activities dedicated to promoting the CACFP. Advertising and Public Relation costs must be necessary and reasonable to meet Program goals (such as outreach events). State agencies have the authority to establish allowable cost thresholds for this category.

a Allowable Costs.

(1) The cost of advertising media to:

(a) Solicit bids for the procurement of Program goods and services;

(VIII I 3 a (1))

and (b) Recruitment of personnel for the Program;

(c) Disposal of scrap or surplus materials acquired in the performance of the Program.

(2) With prior written approval, advertising and public relation costs for pamphlets, news releases and other information services to:

(a) Inform individuals, groups or the general public about the CACFP; or

(b) Increase an institution's CACFP participation.

b Unallowable Costs. All other advertising and public relation costs are unallowable, including:

(1) Costs to solicit non-Program business;

(2) Costs to increase attendance of individuals not eligible for the CACFP; and

(3) Costs of meetings or other events related to fundraising or non-CACFP organizational activities including:

(a) Displays;

(b) Demonstrations;

(c) Exhibits;

(d) Costs of memorabilia, such as gifts, tote bags or souvenirs;

(e) Costs of meeting rooms, hospitality suites or other special facilities used in conjunction with shows and other special events; and

(f) The cost of services, including salaries and wages of employees engaged in setting up and displaying exhibits, making demonstrations or providing briefings.

4 Audits. Audits include both organization-wide and Program-specific audits meeting the requirements of 7 CFR Part 3052.

(VIII I 4)

a Allowable Costs. Either:

(1) The share of organization-wide audit costs based on the percentage of CACFP funds expended to the total of all funds (Federal and non-Federal) expended by the institution during the fiscal year being audited; or

(2) The full cost of a Program specific audit conducted pursuant to 7 CFR §3052.235; and

(3) Other audit costs if included in a cost allocation plan or indirect cost rate proposal, or if specifically approved by FNS as a direct cost to the CACFP.

b Unallowable Costs.

(1) Any portion of the cost of a Program-specific or organization-wide audit funded with CACFP audit funds, currently provided at 7 CFR §226.4(j); and

(2) Costs for any audits other than those identified in item a, above.

5 Bad Debts and Losses. All bad debts and losses are unallowable. Debts and losses result from an institution being unable to collect overclaims from facilities, late payment charges and insufficient fund charges to the institution, Program disallowances, audit or review overclaims, other claims, related collection costs and legal fees. Bad debts and losses also include increases in labor or other costs incurred by institutions reimbursed at the lesser of allowable costs or per-unit rates, solely for the purpose of maximizing CACFP reimbursement to repay debts or losses and administrative or operating cost deficits resulting from complying with Program requirements or attending training. Please see item 30 a, below, for allowable participant support costs.

6 Bonding Costs. Bonding costs arise when an institution is required to provide an assurance against financial loss to the Program. Bonding costs also arise when the institution requires similar assurance from others. Application requirements that impose any form of bonding or surety as a prerequisite to initial Program approval are not permitted except as provided in item a, (2) below. Renewal requirements that impose any form of bonding or surety as a prerequisite for subsequent Program approval are not permitted, except as provided in items a, (3) and (4) below.

a Allowable Costs. Bonding costs must be in accordance with sound business practices and must be obtained from companies holding certificates of authority as acceptable sureties. A list of these companies is published annually by the Department of Treasury in its Circular 570. When the bond coverage reflects only

(VIII I 6 a)

Federal money, the bond must be made payable to the State agency. Allowable bonding costs are limited to:

(1) The cost of premiums on bonds covering employees that handle Program funds;

(2) The pre-agreement and post agreement costs of bonding imposed by State or local statute, regulation or written policy as a prerequisite for initial Program approval whether the bond is secured prior to or after initial Program approval;

(3) The costs of bonding for Program renewals for institutions subject to (2) above, not to exceed the maximum period required by State or local statute, regulation or written policy; and

(4) The cost of bonding imposed by the State agency as a component of a corrective action plan to resolve serious deficiencies.

b Unallowable Costs. The cost of bonding for general administrative staff, officers or any individual not responsible for handling Program funds, except when required by item a, above.

7 Collateral. The cost of collateral is never allowed. See item IX D 8, for more information about collateral on loans.

8 Communication and Technology Costs. Communication and Technology costs include the costs of supplies, services, and equipment such as landline telephones, cellular telephones, ADP equipment and supplies, ADP software, fax, Internet and connectivity services, postage and messenger services. Costs for supplies and services must be allocated between Program and non-Program use.

a Allowable Costs. With specific prior written approval, the costs of supplies, services and equipment used for Program operations that are purchased or leased by the institution are allowable.

(1) The pro-rated cost of cellular telephones, connectivity costs such as cellular data plans, mobile hotspots, air cards, and internet charges are allowable if:

a) The supplies or services meet a demonstrated need for the efficient and effective administration of the Program;

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b) All equipment, supplies and services are used for Program purposes; and

c) The institution has developed adequate internal monitoring procedures to ensure equipment, supplies, and services are used only for Program purposes, and that cost allocations between Program and non-Program use are reasonable.

2) The cost of ADP equipment is allowable provided that it is necessary for the efficient and effective operation of the Program.

a) ADP equipment includes both software and hardware and is defined by the 40 U.S. Code §759(a)(2)(B).

b) ADP equipment is considered to be “General Purpose Equipment,” and, as such, if the acquisition cost for ADP software or hardware surpasses the cost-based definition of equipment, it cannot be directly expensed without the State agency’s prior approval.

b Unallowable Costs.

(1) Supplies or services purchased or leased by the institution that are transferred to officers, trustees, directors, consultants or to employees for any reason, including employment incentives, awards or fringe benefits; and

(2) The cost of communication supplies and services used for non-Program purposes regardless of ownership.

9 Contingencies. The costs of contributions to a contingency fund or any similar provision for unforeseen events are unallowable. Contingency funds do not include allowable self-insurance reserves (see item 21 a(1)(b), below) and pension plans established pursuant to IRS and Government-wide requirements (see: 2 CFR Part 225, Appendix B 9; 2 CFR Part 230, Appendix B 9; and 48 CFR 31.205-6(j)). State agencies should closely monitor budgeted line items on a regular basis throughout the fiscal year in order to address unforeseen contingencies.

10 Contribution and Donation Costs. Contributions and donations include cash, property, goods and services.

a Allowable Costs. With specific prior written approval, the costs required to make goods or services donated to the institution usable for the Program.

b Unallowable Costs. Cash and the value of noncash contributions and donations made by the institution to others.

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11 Criminal and Civil Proceedings, Claims, and Appeals. This paragraph includes costs of the institution before, during and after commencement of judicial or administrative proceedings, excluding costs for administrative appeals conducted pursuant to 226.6(k), (see item 2, above), in connection with the defense and prosecution of any criminal, civil, or administrative proceeding initiated by the Federal, State, local or foreign government when the proceedings relate to a violation of, or failure of the institution, its agents or employees to comply with a Federal, State, local or foreign statute or regulation. These costs include administrative and clerical costs, costs of legal services, professional services, other costs incurred by the institution, its employees, officers, directors and trustees. These costs are not allowed when the institution does not prevail in the proceeding, except as provided in items a, (1) and (2) below. This category also does not include a sponsoring organization's cost to pursue administrative and judicial recovery of funds due from sponsored facilities (see 24, below) or provider appeal costs (see 30 a(3), below). Further, costs are generally limited even when the institution prevails in the proceeding (see item a(3), below). Costs are also limited when the institution initiates proceedings seeking judicial or administrative review of actions rendered pursuant to 7 CFR §226.6(k) (see b(3), below). Institutions must follow the recordkeeping requirements in item c below, in all cases.

a Allowable Costs.

(1) When the proceeding is initiated by the Federal Government and is resolved by consent or compromise, costs are allowed to the extent specifically provided for in the settlement agreement between the institution and the Federal Government.

(2) When the proceeding is initiated by a State or local government, FNS may allow the costs when FNS determines the institution incurred the costs as a result of a specific term or condition of the CACFP or as a result of specific written direction of an authorized official of FNS.

(3) When the institution prevails in the proceeding, FNS may allow the costs to be paid from the administrative funds to the extent that:

(a) The costs are reasonable in relation to the activities required to resolve the proceeding and underlying cause of action;

(b) Payment of the costs is not prohibited by any other provision of the award, regulations or this Instruction;

(c) The costs are not recovered from any other source; and

(VIII I 11 a (4))

(d) The percentage of costs allowed does not exceed 80 percent of the cost of the proceedings except as provided in item a(1), above.

b Unallowable Costs

(1) All costs when the proceedings result in any of the following dispositions:

(a) Conviction;

(b) A determination of organizational liability;

(c) Imposition of a monetary penalty or restitution;

(d) Suspension, debarment, Program termination, recession or voiding of a Program agreement because of a violation or failure to comply with law or regulation; or

(e) Disposition by consent or compromise if the action could result in any disposition described in items (a)-(d) above.

(2) When more than one proceeding involves the same alleged misconduct, the costs of all of the proceedings, if any one of them results in one of the dispositions shown in item b(1), above.

(3) The institution's costs of any services, information, and materials used in an administrative appeal allowed by §226.6(k) when an institution subsequently uses the services, information or materials to pursue State, local or Federal judicial or administrative review of the decision rendered pursuant to §226.6(k), if this subsequent review results in a decision sustaining the review officer's decision, in whole or in part, or one of the dispositions shown at item b(1), above.

(4) The institution's costs in defense of suits brought by employees or ex-employees under section 2 of the Major Fraud Act of 1988 (Public Law 100-700), when the organization settles or is found liable.

(5) The institution's costs in connection with defense against Federal Government claims, judicial appeals, antitrust suits, or prosecution of claims or administrative appeals against the Federal Government, except for appeals pursuant to §226.6(k).

(VIII I 11)

c Documentation Requirements.

(1) The institution must segregate and account for costs that are or may be unallowable by this subsection.

(2) Payment of these costs must generally be withheld until after resolution of the proceedings. However, upon written approval by FNS, the costs may be claimed and conditional payment made upon:

(a) Receipt by FNS of a specific written recommendation from the State agency explaining why payment is in the best interests of the Program;

(b) Provision of adequate non-Federally funded security; and

(c) Receipt by FNS of an agreement executed by the State agency and the institution that all costs reimbursed with CACFP funds subsequently determined to be unallowable will be repaid with interest from non-Federal sources.

12 Day Care Home Licensing Standards Costs. Day care home sponsoring organizations are eligible to use up to \$300 of administrative funds per day care home to enable certain income eligible homes to meet licensing, registration or alternate approval standards.

a Allowable Costs. With specific prior written approval, when the following are required to permit an income eligible (tier I) day care home to meet licensing, registration or alternate approval standards, the following costs are allowable:

(1) Supplies such as smoke detectors and fire extinguishers;

(2) Minor alterations such as adding handrails on a staircase to a basement where the day care operation is being conducted; and

(3) Licensing fees and related expenses such as fingerprinting costs and the cost of health and fire inspections.

Note: Specific prior written approval is not needed for each individual provider needing assistance; the sponsoring organization may submit one request for authority to give assistance for all licensing costs in the budget.

(VIII I 12)

b Unallowable Costs.

- (1) Any other cost to meet licensing or alternate approval standards for income eligible homes;
- (2) General remodeling or renovation; and
- (3) All costs of the institution and day care home to meet licensing or alternate approval standards when the day care home is not income eligible (tier II) to receive these funds.

c Documentation Requirements

- (1) The day care home must submit to the sponsoring organization:
 - (a) An application for participation in the Program;
 - (b) An income eligibility application that documents the day care home's eligibility as a tier I provider;
 - (c) Evidence of the day care home's application for licensing; and
 - (d) Official documentation of the defects that are impeding approval of the license.
- (2) The day care home sponsoring organization must:
 - (a) Maintain the information identified in item c (1), above for each day care home;
 - (b) Maintain a copy of the pre-approval inspection report that identifies the needed supplies or alterations when alternate approval is used;
 - (c) Maintain the fee schedule from the appropriate regulatory/inspection agency for required inspections or licensing/registration to document the cost of such services; and
 - (d) Maintain receipts, delivery notices, inspection reports, copies of approved licenses/registration, canceled checks and similar

(VIII I 12 c (2)(d))

information which documents that the approved costs have been paid and the day care home received the supplies or alterations; inspections were conducted and licensing fees paid, whether or not the day care home becomes eligible to participate in the CACFP.

13 Depreciation and Use Allowance.

a Depreciation, General. Depreciation is the allocation of the cost of acquiring or materially improving a capital asset, to all accounting periods (fiscal years) whose Program operations benefit from an institution's use of the asset. Capital assets whose cost may be depreciated include tangible property, such as buildings, furniture, motor vehicles, and other equipment; and certain intangible property such as computer software. While land is also a capital asset, its cost can never be depreciated.

Depreciation is based on the following factors:

(1) The asset's acquisition cost. This includes the invoice price and any additional charges necessary to make the asset ready for its intended Program purpose. Such additional charges may include transporting the asset from the vendor or manufacturer to the institution, insuring it while in transit, preparing the site for its installation, installing it, testing it, etc. Whether any of these costs are deemed elements of a capital asset's acquisition cost depends on the institution's accounting policies.

(2) The asset's expected useful life. This is the time period during which the asset is expected to remain useful to the institution for Program purposes, not how long it will last. See paragraph g, below, for more information on assets' useful lives.

(3) The costs of improvements or alterations that materially increase the asset's value or prolong its useful life.

(4) The asset's depreciable cost is its acquisition cost, as adjusted for the costs of improvements or alterations subsequent to acquisition. How an institution allocates the depreciable cost to the fiscal years comprising the asset's useful life depends on the depreciation method used.

b Depreciation Methods. U.S. GAAP recognizes several methods of computing depreciation. Any such method used by an institution must result in equitable charges, considering the nature of the depreciable assets, their useful lives, and the benefits received by the Program. Also, the depreciation method(s) used for the Program must be consistent with the method(s) the institution uses for its other Federally-sponsored and non-Federally sponsored activities. The following methods are available:

(VIII I 13 b)

(1) Straight Line Method. The institution divides the asset's depreciable cost, minus its scrap value if applicable, by its useful life (in years) to obtain the portion allocable to each fiscal year. Unless the asset's depreciable cost or useful life is adjusted to account for subsequent improvements or alterations, this method generates the same amount of depreciation expense each fiscal year that the asset is used.

(2) Units of Output Method. This method determines the consumption of an asset's depreciable cost by counting the asset's quantifiable units of output. Useful life and actual usage are expressed in terms of such units rather than fiscal years of use. For example, this method may be appropriate for motor vehicles, whose useful life and actual usage per fiscal year can be expressed in terms of miles driven.

(3) Accelerated Depreciation Methods. Examples of accelerated methods include Sum of the Years' Digits, Double Declining Balance, etc. These methods are front-end weighted; they generate the most depreciation expense in the first year of an asset's useful life, with the depreciation expense declining each subsequent year the asset is used. The theory underlying accelerated methods is that the decline in depreciation expense over time is offset by increasing maintenance and repair costs as the asset ages. Accelerated methods thereby facilitate charging a uniform rate of asset usage throughout the asset's useful life.

See item 16, below, and IRS publications 534 and 946 for additional information on methods of depreciation.

c Use Allowance. Use allowance is an alternative to depreciation that an institution can use if it has not maintained adequate property cost records upon which to base depreciation expense. The use of this method requires a reasonable estimate of the asset's original acquisition cost, which must be approved by the State agency. Once the institution has obtained such prior approval, it can compute annual use allowance by applying a prescribed rate to the asset's estimated acquisition cost. The rate to use depends on the class of asset involved; see subparagraphs d(2)(c) and d(3)(b), below for more information.

d Allowable Costs.

(1) All capital assets.

(a) The use of any depreciation method other than straight line requires specific prior written approval of the State agency.

(b) The acquisition cost for capital assets donated to an institution is limited to the costs the institution incurs to take possession of the property and make it usable for its intended Program purpose. The value of the

(VIII I 13 d (1)(b))

donated property itself is not depreciable because it does not represent a cost to the institution.

(c) The data used to establish the acquisition cost, upon which depreciation or use allowance is based, are drawn from actual cost records. If an institution has not maintained such records, they may use a reasonable estimate of the asset's original acquisition cost. This requires specific prior written approval of the State agency.

(2) Space and facilities. Whether privately or publicly owned, the cost of buildings can be depreciated using 30-year straight line or the depreciation method used and accepted for purposes of reporting to the IRS. The following requirements also apply:

(a) The acquisition cost upon which depreciation or use allowance is based must exclude the cost of land;

(b) For publicly owned buildings, the amount assigned as the acquisition cost requires specific prior written approval; and

(c) The maximum annual rate for use allowances for buildings and improvements thereto cannot exceed 2 percent of the acquisition cost less the cost of land.

(3) Equipment. This category includes motor vehicles, computers, copiers, office furniture, food service equipment, etc.

(a) An institution may use either 15-year straight line depreciation (5 years for motor vehicles and computer equipment) or the method used and accepted for purposes of reporting to the IRS.

(b) The maximum annual rate for equipment use allowances cannot exceed $6 \frac{2}{3}$ percent of the acquisition cost.

(4) Computer software. An institution may use either 3-year straight line depreciation or the method used and accepted for purposes of reporting to the IRS.

e Unallowable Costs.

(1) No depreciation expense or use allowance may be claimed for Program reimbursement or charged to an institution's nonprofit food service account for any portion of a capital asset's cost that had been:

(VIII I 13 e (1))

- (a) Paid by the Federal Government;
- (b) Donated by the Federal Government or others, regardless of where title was originally vested or where it presently resides; or
- (c) Contributed by the institution to satisfy matching requirements for any Federally-funded Program.

(2) Equipment replacement reserve fund costs, including contributions to contingency funds, are unallowable.

f Documentation Requirements. All depreciation claimed for Program reimbursement, or charged to an institution's nonprofit food service account, must be documented through depreciation records indicating the amount of depreciation taken each period and, when appropriate, allocated between Program and non-Program use.

(1) Property records and inventories. All depreciation charges must be supported by adequate property records and physical inventories that are taken at least once every two years to ensure the items exist, are in good working order and are actually used for Program purposes. Exhibit D, attached, contains a suggested format and instructions for recording equipment and depreciation. This format may be adapted for use with other depreciable assets. Records in memorandum form can also be used to document depreciation.

(2) Record retention. All records must be retained during the asset's useful life and for 3 years after the end of the Federal fiscal year during which the item was fully depreciated or disposed of, whichever occurs first. Records must be retained beyond this period if audit findings have not been resolved.

g Useful Lives of Capital Assets. Expected useful lives will vary for different classes of capital assets, and should be established by the institution based upon reasonable criteria. Examples of expected useful lives of different classes of assets include:

- (1) Motor vehicles – 5 years
- (2) Computer equipment – 5 years
- (3) Computer software – 3 years
- (4) Office equipment – 3 to 5 years
- (5) Telephone systems – 5 years
- (6) Office furniture – 10 years

(VIII I 13 g)

Several factors can necessitate modifying these figures. Examples include:

- (1) Frequency of use,
- (2) Age of the assets when acquired,
- (3) The institution's maintenance and repair policies,
and
- (4) Environmental conditions.

The useful lives used by an institution may also be subject to specific prior written approval at the discretion of the State agency. For additional information on the life expectancy of an item, see the IRS Publications 534 and 946.

14 Employee Morale, Health, and Welfare Costs and Credits.

Employer costs for in-house publications, first-aid clinics, recreational activities, employee counseling services and other expenses in accordance with the institution's established practice or custom for improvement of working conditions, employer-employee relations, employee morale and employee performance are included in this category. Specific prior written approval is required for all costs in this category. (See 2 CFR Part 230, Appendix B, Section 13.)

a Allowable Costs.

(1) For all institutions, the costs of professional crisis intervention counseling and emergency medical care when these costs are a direct result of the institution's participation in the CACFP.

(2) The current cost of benefits provided to Program employees when the institution provided the benefits to all members of the same class of employees prior to the institution's participation in the CACFP.

(3) The cost of new or expanded benefit Programs when the institution provided benefit Programs to all members of the same class of employees prior to the institution's participation in the CACFP.

b Unallowable Costs.

(1) The cost of new or expanded benefit Programs when an institution, receiving a predominant amount of its support from the CACFP, did not have pre-existing benefit Programs for the same class of employees;

(2) The costs of the employee's share or required employee copayments for benefit Programs;

(VIII I 14 b)

(3) The cost of benefit Programs extended to the employee's family members. Please see item 23 g(2) below for information on family member health benefit plan costs;

(4) The cost of social functions such as office parties, picnics, award luncheons, dinners or banquets, retirement, holiday or birthday celebrations, etc., (see item 15, below);

(5) The costs of flowers, prizes and gifts, (see item 23 I 6);

(6) The costs of benefits that are limited to owners, officers, directors, trustees or family members thereof.

c Documentation Requirements.

(1) The institution's established practice or custom for providing the benefits must be documented;

(1) The costs must be equitably assigned to all activities of the institution;

(2) Income generated from employee morale benefit and welfare Programs must be credited to the cost of these Programs, unless such income has been irrevocably sent over to employee welfare organizations.

15 Entertainment and Social Function Costs. Amusements, social activities, fees for motivational, social, or inspirational speakers and costs incidental to social functions including entertainment, meals, beverages, gifts, prizes, lodging, rentals, transportation and gratuities are unallowable.

16 Expensing of Equipment Purchases and Other Capital Expenditures. Direct expensing means charging a capital expenditure as a direct cost to the institution's nonprofit food service account, or claiming it for Program reimbursement (if applicable), at the time the items are purchased or improvements are made. As explained in Exhibit A, Glossary, to this Instruction, a capital expenditure is the cost of purchasing equipment or other capital assets, or making improvements thereto that materially increase the assets' value or materially prolong their useful lives. Direct expensing is an alternative to charging the cost of capital expenditures via depreciation expense. However, an institution can use direct expensing only with specific prior written approval of the State agency.

(VIII I 16)

a Allowable Costs. With the State agency's specific prior written approval, an institution may directly expense capital expenditures for the following items:

(1) General purpose equipment. This category includes equipment whose usefulness is not limited to research, medical, scientific, or other technical activities, whether or not special modifications are needed to make the equipment suitable for a particular purpose. Examples of general purpose equipment include office equipment and furnishings, air conditioning equipment, reproduction and printing equipment, motor vehicles, and ADP equipment. (See 2 CFR Part 225 and Part 230, Appendix B, paragraph 15(a)(4).)

(2) Land or buildings.

(3) Improvements to land, buildings, or equipment which materially increase their value or, in the cases of buildings or equipment, materially prolong their useful lives.

(4) Intangible assets, such as copyrights, patents, or computer software.

b Unallowable Costs. The following items can never be directly expensed:

(1) Equipment purchases and other capital expenditures for property used in indirect cost activities. Such expenditures can be charged as indirect costs only via depreciation.

(2) The cost of improving rental space or rented facilities.

(3) The cost of equipment or other property purchased by individuals.

(4) The fair market value or other imputed cost of equipment or other capital assets donated to the institution.

c Documentation Requirements.

(1) All sponsoring organizations of day care homes and any other institution reimbursed on the lesser of meals times rates or cost must comply with Federal property management requirements when the acquisition cost of equipment has been charged, in whole or part, to the Program. Exhibit D can be used to meet the recordkeeping requirements.

(VIII I 16 c)

(2) Specific transfer and disposition instructions apply when the equipment or other property has a per-unit fair market value that meets or exceeds the Department's grant administrative disposition threshold, currently set at \$5,000 or more. Refer to 7 CFR §3016.32(e) or §3019.34(g), as applicable, for the \$5,000 fair market value rule regarding equipment.

Refer to 7 CFR §§3016.31-.33 and §§3019.30-.37, as appropriate, for additional information on recordkeeping, property trust relationship and its requirements, transfer, and disposition instructions.

d Trade-ins and Exchanges. When equipment or other property is traded for a new item, the maximum amount that can be charged to the Program is the net amount paid.

17 Facilities and Space Costs. Space and facilities costs, including rearrangement and alteration costs (see item a(3) below), may be charged through rental/lease fees (see item 36, below) or depreciation (see 13, above), as appropriate.

a Allowable Costs. Whether in privately or publicly owned buildings, the total cost for space and facilities cannot exceed the rental costs of comparable space and facilities for privately owned buildings in the same locality.

(1) All related party rental transactions for commercial space and facilities are subject to cost limitations, (see item 36 d(3), below).

(2) When a private residence owned by the institution or a related party is used for Program purposes, the costs claimed must meet all IRS requirements for business use of a home and must be supported by the records used to meet the IRS requirements for documenting the business use of the home.

(3) Rearrangement and Alteration. With the State agency's specific prior written approval, the costs for rearrangement and alterations to facilities owned by the institution that are necessary for efficient and effective Program operations but do not result in capital improvements are allowable. Costs incurred for improvements which add to the permanent value of the buildings and equipment or appreciably prolong their intended lives shall be treated as capital expenditures or added to the depreciable cost of the property (see item b(1), below).

(4) Meeting state and local health standards is a regulatory Program requirement, and thus ordinary and necessary for the operation of the Program. Fees charged for inspections of At-Risk Afterschool Care Centers and Outside School Hours Care Centers would be allowable costs for those entities under the CACFP, (see VII, A, 3).

(VIII I 17)

b Unallowable Costs.

(1) The costs of rearrangement and alterations to facilities owned by the institution requiring construction, structural changes to the facility or that otherwise result in capital improvements to the facility, but in some cases these costs may be depreciated, (see item 13, above);

(2) Costs for any rearrangement and alteration to rental space; and

(3) Costs to bring either owned or rented facilities into compliance with State and local requirements except for certain costs to obtain licenses for day care homes, (see item 12, above.)

c Documentation Requirements. All space costs, including rearrangement and alterations, must be allocated between Program and non-Program use and the Program share of the costs must be allocated between operating and administrative costs.

d Special Consideration. The following space and facilities costs require specific prior written approval:

(1) All special lease arrangements, (see item 36 d, below);

(2) Costs incurred by the institution during periods of non occupancy; and

(3) A single base such as square footage to allocate maintenance and operation costs between Program and non-Program activities when these costs are not included in rent or other space charges.

18 Fines, Penalties and Restitution. All costs resulting from the institution's failure to comply with Federal, State and local laws and regulations are unallowable.

19 Food Costs. See Exhibit B for guidance on determining food costs.

20 General Business Expenses. The costs of conducting the general business of an organization are unallowable. These costs include compensation to members, officers, directors, trustees, and associates (see also item 23 d, below); stipends for attendance at corporate meetings conducted pursuant to State or local incorporation

(VIII I 20)

requirements; costs of organization and reorganization; stock offering and stock redemption costs; and any cost incurred to meet or maintain the institution's incorporation or not-for-profit status, such as filing Federal and State income tax returns or their equivalent (Forms 990 for organizations exempt from income tax under section 501(3) of the Internal Revenue Code, etc.).

21 Insurance. Insurance includes premiums on insurance policies, contributions to self-insurance reserves, and deductible payments for minimal losses. This category does not include life, disability or health care insurance provided to individuals. (See item 23 g, below.)

a Allowable Costs.

(1) The costs of insurance required by the State agency that are identified in the institution's Program agreement and maintained pursuant to that agreement are allowable.

(2) With specific prior written approval, the following insurance costs are allowable:

(a) Costs of other insurance maintained by the institution in connection with the general activities of the Program when the type, extent and cost of coverage is in accordance with general State or local government policy and sound business practices;

(b) Costs of insurance or contributions to any self insurance reserve covering the risk, loss or damage to Federal Government property to the extent that the institution is liable for such loss or damage;

(c) Cost of insuring the lives of Directors and Officers, provided that:

(i) The insurance policy actually provides liability coverage related to the CACFP; and,

(ii) If the policy also provides coverage for non-CACFP liability, the CACFP share of the cost is properly allocated.

(d) Contributions to a reserve for self-insurance to the extent that the reserve meets State insurance requirements and the type of coverage, extent of coverage and the rates and premiums would have been allowed had insurance been purchased from a commercial provider to cover the risks; and

(VIII I 21)

(e) The State agency may waive specific prior written approval of minimal losses not covered because of insurance deductibles and other minor losses not covered by insurance that occur in the ordinary course of operations such as spoilage, breakage and the disappearance of immaterial quantities totaling less than \$100 annually.

b Unallowable Costs.

(1) The allocated share of insurance coverage costs for non-Program activities.

(2) The cost of actual losses that could have been covered by permissible insurance through the purchase of insurance or an approved self-insurance plan unless expressly provided for in the State agency-institution agreement.

22 Interest, Fundraising, and Other Financial Costs. This category includes interest on debt, fees and charges in lieu of interest, all fundraising costs and other financial costs, including expenses to enhance income from investments. This category does not include interest earned by the institution from Program or non-Program operations or investments. (See item IX D 7, below.)

a Allowable Costs.

(1) Bank services fees for Program accounts, including the Program share of fees for commingled accounts, for check printing and routine account servicing charges.

(a) With specific prior written approval:

(i) "Stop payment" charges for facility advance and reimbursement payments and other Program disbursements, whether by check or EFT (The State agency should develop a procedure to determine how to handle these charges); and

(ii) Program account reconciliation and analysis fees, including the allocated share of fees charged for commingled accounts.

(2) With specific prior written approval, interest incurred after October 1, 1998, for nonprofit private institutions (see: 2 CFR Part 230, Appendix B, 23) and after October 1, 1980, for public institutions (see: 2 CFR Part 225, Appendix B, 23), on institutional debt used to acquire or replace allowable equipment or other property or make allowable improvements. (See item c, below, for more information.)

(VIII I 22)

b Unallowable Costs.

- (1) Insufficient fund charges;
- (2) Bank servicing and account charges for non-Program accounts, including the allocated share of these costs for commingled Program and non-Program fund accounts;
- (3) Interest expenses in excess of the actual interest paid;
- (4) Interest expenses for any debt the institution is not legally obligated to pay;
- (5) Interest on borrowed funds used to acquire equipment or other property not allowable as a direct expense to the Program (see item 16, above);
- (6) Interest on borrowed capital or the temporary use of endowment funds, however represented;
- (7) Interest for reacquiring equipment or other property held by the institution or a related party through repurchase or refinancing arrangements;
- (8) Credit card interest debt;
- (9) Cost for failure to pay debt timely (interest and late charges);
- (10) Fees and charges in lieu of unallowable interest;
- (11) All taxes and legal and professional fees paid in connection with financing and refinancing operations;
- (12) Costs of fundraising, including financial campaigns, endowment drives, solicitation of gifts and bequests and similar expenses incurred solely to raise capital or obtain contributions;
- (13) Costs of investment counsel, staff and similar expenses to enhance income from investments;

(VIII I 22 b)

(14) All interest and principal when a less-than-arms-length financing arrangement was not fully and accurately disclosed to the State agency and FNSRO (see item c, below); and

(15) In a less-than-arms-length transaction, interest expense in excess of the fair market rate available to the organization from an unrelated party.

c Documentation Requirements for Financing Arrangements.

(1) Arms-length transactions. At a minimum, the institution must submit the following information when requesting specific prior written approval:

(a) For a nonprofit or proprietary institution, a notarized, original signature certification by the institution's chief executive officer and the financing institution that the financing arrangement is a bona-fide arms-length transaction between unrelated parties;

(b) For a public institution, certification by the public agency's chief legal official that the financing arrangement meets all applicable State and local requirements regarding public agency indebtedness;

(c) A bona-fide, written financing document executed by a designated official of the financing institution and the chief operating officer (nonprofit institution or proprietary) or appropriate public agency official (public institution). This document must include the terms and conditions of the financing arrangement, identification of any collateral or security provided by the institution and the nominal and effective interest rates; and

(d) A notarized copy of all documents recorded pursuant to State or local requirements in furtherance of the financing arrangement.

(2) Less-than-arms-length transactions. Specific prior written approval by FNSRO and the State agency is required.

(a) Institution requirements. When the financing arrangements are not arms-length, the institution must provide the State agency with:

(i) Full disclosure of the transaction;

(ii) A written financing document executed by a designated official of the institution and lender that includes the terms and

(VIII I 22 c (2)(a)(ii))

conditions of the financing arrangement, identification of any collateral or security provided by the institution, and the nominal and effective interest rates;

(iii) Documentation from at least three (3) commercial or public financing sources providing the interest rate that would be offered to the institution if an arms-length transaction was used; and

(iv) The documents required in item c(1) (d), above.

(b) The State agency must provide FNSRO with:

(i) The documents submitted by the institution;

(ii) Certification from the State agency that the financing arrangements meet all requirements for an allowable transaction; and

(iii) A recommendation to approve or deny the request.

23 Labor Costs. This category includes all forms of compensation earned and all forms of payment, cash and noncash, for personal services for Program administrative and operating labor. Subsections 23 (a)-(d) establish the general requirements for labor costs. Subsections 23 (e)-(l) provide guidance on specific elements of labor costs.

a Allowable Costs. Each element of an individual's compensation must be reasonable for the services provided by the individual and conform to the institution's written compensation policy. The Program cost for compensation is limited to Program work performed during the current grant period by individuals employed by the institution. Elements of compensation include:

(1) Salaries and Wages: Compensation for personal services includes payment for all services rendered by employees during the period of the grant award, whether paid currently or accrued. For further information, refer to the section *Salaries and Wages*, item 23, e.

(2) Taxes: The Program's allocable share of Federal, State, and local employment taxes and Social Security are allowed. For further information, refer to *Taxes*, item 23, f.

(VIII I 23 a)

(3) Fringe Benefits: The Program's allocable share of fringe benefits includes such benefits as vacation leave, sick leave, military leave, health benefits, life and disability insurance, and paid non-work holidays. For further information, refer to *Fringe Benefits*, item 23 g.

(4) Overtime compensation, holiday pay and compensatory leave: Payment of overtime, holiday pay for work performed on a non-work holiday and compensatory leave is allowable. For further information, refer to *Overtime, Holiday Pay, and Compensatory Leave*, item 23 h.

(5) Incentive Payments and Awards: Prior approval is required except for nominal awards whenever these are considered. For further information, refer to item 23 i.

(6) Severance Pay: Severance pay or dismissal wages is compensation paid to an employee whose employment is terminated. The cost of severance pay is allowable. For further information, refer to item 23 j. Also see items b(18) and (19), below.

(7) Deferred Compensation: Salaries and wages or benefits earned by an employee in one period that are not paid to the employee until a future period is allowed. For further information, refer to item 23 k.

(8) Value of Donated Labor: Whenever compensation is not given for Program labor, the labor is a donation and cannot be charged as a cost to the Program. The value of donated labor must be used in the determination of the organization's indirect cost rate. For further information, refer to *Donated Labor*, item 23 l.

b Unallowable Costs.

(1) Any payment for services rendered by, or the costs of benefits for individuals not employed by the institution, except for certain health care benefits (see item 23 g, below);

(2) Compensation in any form incurred, accrued or paid inconsistent with the institution's written compensation policy;

(3) Increases in compensation costs resulting from the institution changing its treatment of specific types of compensation unless the change is directed by FNS, the State agency or required by Federal or State statute;

(4) Retroactive salary or wage increases;

(VIII I 23 b)

(5) Compensation in any form based on the number of day care homes recruited including from non-Program funds according to 7 CFR §226.16 (m).

(6) Compensation in any form paid, incurred or accrued solely as a means of maximizing available reimbursement;

(7) Costs claimed for reimbursement or charged to the institution's nonprofit food service account that do not comply with all Federal and State employment compensation and taxation requirements;

(8) The employee's share of taxes and fringe benefit costs;

(9) Costs of disability and life insurance policies for officers, directors, trustees and employees when the organization is the beneficiary;

(10) Any cost that is not determined and documented in accordance with this Instruction;

(11) Overtime, compensatory time or awards resulting from the institution's failure to obtain and maintain a sufficient number of qualified employees to administer the Program except when necessary to cope with emergencies such as those resulting from accidents, natural disasters, breakdowns of equipment, or occasional operational bottlenecks of a sporadic nature;

(12) Compensation incurred in any form to repay debts, overclaims or disallowances;

(13) Deferrals of any form of compensation to avoid funding limitations or to obtain funds to repay debts, overclaims or disallowances;

(14) Incentive payments or awards in any form other than cash or additional vacation leave;

(15) Incentive payments or awards given prospectively to employees to improve performance:

(16) Incentive payments or awards to contractors, board members, officers of the institution or any individual who is not an employee of the institution;

(17) Gifts, social events, luncheons, dinners, banquets or entertainment;

(VIII I 23 b)

(18) Severance pay when the individual's employment was terminated for:

- (a) Program misconduct;
- (b) Violations of Program requirements;
- (c) Violation of the organization's ethics and code of conduct requirements; or
- (d) Conviction for criminal misconduct.

(19) Costs for certain severance packages, commonly known as a "golden parachute" payment;

(20) The cost of goods and services for personal use of the institution's officers, employees, trustees, directors, or family members, thereof, regardless of whether the cost is reported as a direct cost, indirect cost, fringe benefit or taxable income to the individual; and

(21) The portion institution-furnished automobiles that relates to personal use by the employee, director, officer, trustee, committee member or family member, thereof, regardless of whether the cost is reported as a fringe benefit, direct cost, indirect cost or taxable income to the individual.

c Documentation Requirements.

(1) Institutions must establish and maintain a written compensation policy for every element of compensation charged to the Program. At a minimum, the written compensation policy must apply to any individual or group of individuals employed by the institution and identify:

- (a) Rates of pay;
- (b) Hours of work, including breaks and meal periods; and

(c) The institution's policy and payment schedule for regular compensation, overtime, compensatory time, holiday pay, benefits, awards, severance pay and payroll tax withholding. The timing and frequency of the institution's payments to its employees will follow a routine schedule as directed by its human resource policy. For example, it may compensate employees weekly, bi-weekly, or monthly.

(VIII I 23 c (1))

(d) The compensation policy must also reflect the requirements of the U.S. Department of Labor's FLSA, which directs whether non-salaried employees are compensated for overtime or compensatory time whenever time worked exceeds eight hours per day or forty hours per week.

(2) Time and attendance reports for all labor costs (salaries, wages and benefits) charged to the Program for hourly or salaried employees for part-time, full-time or piece-work. These reports must identify the total time actually worked by the employee, not just the time spent on Program activities.

(a) At a minimum, these reports must include:

(i) Start time;

(ii) End time; and

(iii) Absences.

(b) The report must be prepared timely and coincide with the employee's pay period.

(i) For employees with fixed start and end times, the time and attendance report must be prepared daily for all periods of absences beyond normal meal and break periods.

(ii) For employees with variable start and end times, the time and attendance report must be prepared daily. Unless required by the institution, employees with established start and end times are not required to complete daily sign-in and sign-out sheets. At the discretion of the State agency, daily sign-in and sign-out sheets may be required for employees with variable start and end times, unless prohibited by a negotiated labor-management agreement between the institution and its employees.

(3) Time distribution reports. To establish the portion of costs that may be claimed for reimbursement or charged to the institution's nonprofit food service account as Program labor, a daily log or other time distribution method must be used.

(a) These reports must be completed by all employees, both full-time and part-time, and must account for the total activity for which each employee is compensated.

(VIII I 23 c (3))

(b) The portion of the labor costs charged to the institution's nonprofit food service account must be allocated based on the hours worked for Program and non-Program activities and within the Program for administrative and operating cost labor.

(c) A separate report for each employee is required.

(d) The reports must reflect an after-the-fact determination of the actual activity of each employee.

(e) Budget estimates and time studies of any kind are not acceptable documentation.

(f) The State agency must establish the interval for time distribution reporting, however reporting intervals of less than 15 minutes are not permitted. State agencies may require different interval reporting for different positions or classes of employees within an institution, as long as the reporting requirement does not conflict with the institution's approved indirect cost rate agreement, cost allocation plan, 2 CFR Part 225, 2 CFR Part 230, or applicable financial management guidance.

(g) For proprietary and nonprofit institutions, the reports must be prepared at least monthly and coincide with one or more pay periods. (See: 2 CFR 230, Appendix B, 8(m)(2)(d), for more information on nonprofit reporting requirements).

(h) For public institutions:

(i) Monthly time distribution reports are required for each employee that works on Program and non-Program activities when the employee's compensation is charged as a direct cost;

(ii) When an employee's compensation is charged entirely as an indirect cost, the time distribution report requirements are determined by the approved indirect cost rate agreement or cost allocation plan. Specifically, time distribution reports are not required for an employee who works in a single indirect cost activity or in multiple indirect cost activities which are all allocated using the same allocation base; however, an employee who works in two or more indirect cost activities which are allocated using different allocation bases must prepare time distribution reports. (See 2 CFR Part 225, Appendix B, paragraph 8 h (4)(d)); and

(iii) For employees who work only on the Program, certifications completed at least semi-annually can be substituted for time

(VIII I 23 c (3)(h)(iii))

distribution reports. Program salaries that serve both operational and administrative functions must be allocated between those accounts and certification must be completed at least semi-annually. (See: 2 CFR Part 225, Appendix B 8(h)(3) for more information.)

(4) In all cases, time and attendance and time distribution reports must be completed by the employee and signed and certified as true and correct by the employee and a responsible supervisory official having firsthand knowledge of the activities performed by the employee during the period covered by the reports.

(5) Payroll records. At a minimum, a record for each employee containing:

- (a) Employee name;
- (b) Employee identification number;
- (c) Rate of pay;
- (d) Hours worked;
- (e) Benefits earned;
- (f) Any reductions or increases to the employee's base compensation, i.e., overtime pay, incentive award, etc.;
- (g) Gross pay;
- (h) Net pay;
- (i) Date of payment to employee;
- (j) Method of payment, i.e., check, cash, EFT;

and

(k) Verification that the employee has been paid, i.e., canceled checks or EFT deposit verification. For cash payments, an original signature certifying receipt of payment is required.

(6) In addition to the records required by this Instruction, records must be maintained in conformance with 29 CFR Part 516, the Department of Labor regulations implementing the FLSA for all FLSA nonexempt employees.

(VIII I 23)

d Special Considerations in Determining Allowability. When special considerations exist, allowable costs are limited to the amount of compensation approved for the actual performance of Program services. The State agency must determine that the compensation costs are necessary and reasonable for the actual services performed by the individual and do not represent an attempt by institutions reimbursed at the lesser of rates or cost to maximize or distribute excess Program earnings. The following situations always require special consideration and specific prior written approval:

(1) Compensation to members of nonprofit institutions, trustees, directors, associates, officers, or the immediate families thereof;

(2) Stipends to compensate board members for the costs of attending corporate meetings at which Program business is conducted; and

(3) Any change in an institution's compensation policy that results in a substantial increase in the institution's level of compensation to an individual or to all employees.

e Salaries and Wages. Salaries or hourly rates for operating or administrative labor are reasonable when the rates that are charged are consistent with rates paid for similar work in the same area in which the institution is located or consistent with the amounts reported by the U.S. Department of Labor or State labor department for compensation for that field of employment in the same or a comparable geographic location.

f Employment Taxes. The employer's share of Federal, State and local employment taxes such as Social Security withholding tax and State unemployment taxes are allowable if the following conditions are met:

(1) The required periodic payment of Social Security and other taxes must actually be made to the appropriate authority.

(2) Institutions must record employment taxes in the same manner (cash or accrual) and at the same time as the salary or wage benefits upon which these costs are based.

g Fringe Benefits. The employer's share of fringe benefit costs including vacation leave, military leave, health benefits (see item (2) below), life and disability insurance (see items (4) and (5) below), paid non-work holidays (see item h.) below for additional information about holiday pay) and retirement benefits (see item (6), below), when all like (Federally and non-Federally funded) employees receive the same benefits in accordance with the established written policy of the institution.

(VIII I 23 g)

(1) Institutions must record fringe benefit costs in the same manner (cash or accrual) and at the same time as the salary or wage benefits upon which these costs are based.

(2) The costs of family health benefit plans are allowable to the extent the particular officer's or employee's benefit plan costs are allowable.

(3) The cost for an employee's, but not an officer's, individual membership in a professional organization and cost of subscriptions to professional periodicals is allowable when:

(a) The individual is a recognized member of the particular profession such as Certified Public Accountant, Registered Dietitian, etc.

(b) The employee's primary work duties require practicing the profession for the institution's CACFP;

(c) The membership costs is treated as additional compensation to the individual; and

(d) The State agency determines that the individual's total compensation is necessary and reasonable.

(4) The institution's share of premiums for life and disability insurance policies for non-management employees is allowable when the employee's family or others, but not the institution, are the beneficiaries.

(5) Costs for life and disability insurance on the lives of trustees, officers or employees holding similar positions of authority are allowable only when the insurance represents additional compensation and the State agency determines that the individual's total compensation is necessary and reasonable.

Subject to the following conditions, an institution may pay employees for unused benefits (medical savings accounts, vacation and sick leave, etc.) consistent with Federal and State requirements regarding these accounts.

(a) The timing, amount and authorization for payment must be consistent with the institution's written compensation policy;

(b) The benefits must be earned but not used by the employee within the institution's annual business year;

(VIII I 23 g (5))

(c) Since the leave cash-out represents additional compensation, at the time of budget submission, the institution must disclose the maximum amount of additional compensation that each employee may earn through a leave cash-out payment;

(d) The State agency must determine that the employee's total compensation including the benefit cash-out is reasonable;

(e) The costs for the cash-out payment must be charged to the grant year in which the employee earned the benefit; and

(f) The employee must receive the cash-out payment by the close of the first quarter of the next business year or the payment is subject to the requirements for deferrals (See item k, below).

(6) Consult the appropriate source for specific requirements for pension plan costs (2 CFR Part 225, Appendix B 8(e), for public institutions; 2 CFR Part 230, Appendix B 8(i), for nonprofit private institutions; or Federal Acquisition Regulations (FAR) 31.205-6 j, for proprietary institutions).

h Overtime, Holiday Pay and Compensatory Leave. Payment of overtime, holiday pay for work performed on a non-work holiday and compensatory leave is allowable with specific prior written approval for each instance, except as noted in items (2) and (3) below, when an employee will earn overtime, holiday pay or compensatory leave in lieu of overtime.

(1) All overtime, holiday pay and compensatory leave earned must be documented in accordance with item 23 c, above.

(2) During the budget approval process, the State agency can approve intermittent periods of overtime of brief duration to meet regularly occurring workload fluctuations, such as monthly meal count consolidation.

(3) In the case of emergencies, accidents, natural disasters, equipment breakdowns, or occasional operational bottlenecks of a sporadic nature that require immediate attention to protect the Program, specific prior written approval is not required, however, the following requirements apply.

(a) Written documentation must be maintained that identifies:

(i) The specific nature of the emergency or equipment breakdown;

(VIII I 23 h (3)(a))

(ii) The date the event occurred; and
(iii) An explanation of why the event prevented obtaining prior approval.

(b) The institution must notify the State agency in writing that overtime or compensatory time has been incurred and submit the information required in item (3)(a) above within no more than two (2) working days after the emergency ends or the date of equipment breakdown.

(c) Failure to comply with the documentation and notification time frames, including maintaining proof of timely notification to the State agency, will result in disallowance of the costs.

i Incentive Payments and Awards. Except for awards of minimal value (see item (6), below), specific prior written approval is required for the costs of an incentive payment or award given to an employee.

(1) Incentive payments and awards are allowable to the extent the employee receiving the award performed Program labor and

(a) The payment is based on actual services performed by the employee or an employee suggestion that was implemented, which resulted in Program cost reductions through efficient performance, improved working conditions, or a special act or achievement, such as the identification or elimination of a safety hazard;

(b) The compensation is based on an agreement entered into in good faith between the institution and the employee(s) before the services are rendered;

(c) The payment is issued in accordance with the institution's written compensation policy;

(d) The payment takes the form of cash or additional vacation leave; and

(e) The amount of compensation provided is reasonable in terms of the benefits received.

(2) When incentive payments are routinely issued to all or certain employees, these payments cannot be classified as incentives or awards but instead are parts of the employee's regular compensation and must be included when determining if the employee's total compensation is reasonable;

(VIII I 23 i)

(3) The incentive payments can be limited to a specific group of employees, but cannot be limited to specific individuals;

(4) Incentive compensation must be charged to the year in which the applicable portion of the award was earned, not paid. If the award is earned in more than one grant period, the award costs must be allocated to each Federal fiscal year in which the award is earned;

(5) Unfunded incentive award costs cannot be shifted to subsequent Federal fiscal years to avoid funding limitations;

(6) Awards of minimal value such as length of service pins, certificates of appreciation, floral arrangements, live plants, mugs, plaques or other items are allowable to the extent the employee receiving the award performed Program labor. The State agency retains the right to establish a maximum cost for awards of minimal value.

j Severance Pay. Severance or dismissal pay is compensation paid to an employee whose employment is terminated.

(1) The cost of severance pay (2 CFR Part 230 Appendix B, paragraph 8 k (2) and 8 k (2) (a) and (b) and parallel citations in 2 CFR Part 225) is allowable, with specific prior written approval, when severance pay does not constitute excess compensation (i.e., golden parachute provisions) and is required by:

(a) Law;

(b) Written employer-employee agreement executed at the time the employee was hired;

(c) Established written policies of the institution; or

(d) The terms of a negotiated written labor relations agreement.

k Deferred Compensation. Deferred compensation means the salaries, wages or benefits earned by an employee in one period that are not paid to the employee until a future period. Deferred compensation does not include the normal delay that occurs between the time employees earn compensation and the regular periodic disbursement of that compensation. This section also does not apply to deferrals incident to allowable pension plan costs.

(VIII I 23 k)

(1) With specific prior written approval, deferrals of compensation costs for officers and employees are allowable when the State agency determines:

(a) The deferral is in the best interest of the Program; and

(b) The deferral does not represent the establishment of a contingency fund, an attempt to defer compensation as a result of an overclaim, repayment request, or funding limitation or an attempt to acquire Program funds for unallowable cost purposes.

(2) Compensation costs cannot be deferred:

(a) Before the officer or employee earns the compensation from which the deferral will be made; or

(b) For more than the amount of officer's or employee's salary approved in the institution's budget.

(3) Deferrals of unused vacation leave, sick leave and compensatory time earned in lieu of payment for overtime worked by the employee must be consistent with the institution's policy for the use of such leave. For example, when the institution requires officers and employees use all vacation leave by the end of the calendar year in which the leave was earned, the leave cannot be deferred beyond that year.

(4) The institution must submit a plan to the State agency when requesting approval that contains:

(a) A description of the policies and procedures that will be used to accrue deferred salary or fringe benefits;

(b) The purpose of the deferral;

(c) The dates when the deferral will begin and end;

(d) The date when payment of the deferred compensation will be made to the officer or employee;

(e) The names of each officer and employee subject to the deferral;

(VIII I 23 k (4))

(f) The maximum dollar amount of the deferral in total and by individual;

(g) The organization's tax liabilities associated with the deferral;

(h) A description of how the institution will ensure compliance with these individual and organization tax liability requirements; and

(i) A copy of the agreement between the institution and each officer or employee subject to the deferral which embodies all of the information in items 4 (a)-(h) above, bearing the original signatures of the officer or employee and the institution certifying that:

(i) The deferral represents compensation earned by that officer or employee;

(ii) The officer or employees agrees to the deferral; and

(iii) The officer or employee is aware of the personal income tax liabilities associated with the salary or fringe benefit deferral.

(5) All Program funds received by the institution as a result of the deferral must be identified in the institution's accounting records by:

(a) The name of the officer or employee earning the funds;

(b) The date the funds were earned by the officer or employee, the date the funds were claimed for reimbursement; the date the funds were received by the institution, and the date the institution recorded the receipt of the funds in the nonprofit food service account;

(c) The date the cost of the deferred compensation was recorded in the nonprofit food service account; and

(d) The date the deferred compensation is paid to the officer/employee.

(6) Funds received by the institution for deferred salary and fringe benefits must be promptly recorded in the institution's nonprofit food service account, but no later than five working days after receipt.

(VIII I 23 k)

(7) All funds retained in restricted deferral accounts must only be used to liquidate the deferred compensation or deferred fringe benefits.

(8) In no case may funds received for a specific officer or employee be used to liquidate any other officers' or employee's deferred salary or fringe benefits.

(9) If, due to Program funding limitations, the institution does not receive CACFP funds sufficient to reimburse the full amount of each officer's or employee's deferral, the institution cannot carry the unfunded liability into the next Federal fiscal year. The institution must either:

(a) Fund this liability from non-Federal sources;

(b) Submit a revised Program budget and deferral plan amendment identifying appropriate salary, fringe benefit and deferral reductions.

(10) The deferral of each employee's or officer's compensation must be evaluated and approved on a case-by-case basis.

(11) Amendments or modifications to approved deferral plans require specific prior written approval.

(12) Renewals or extensions of deferral plans are not permitted; however an institution may submit a new request after liquidating all deferrals under a previously approved plan.

1 Value of Donated Labor. When compensation is not given for Program labor, the labor is a donation and cannot be charged to the Program, but the value of donated labor must be used in the determination of the institution's indirect cost rate. Unless a bona fide loan or deferral is created, a donation occurs when an officer or employee of the institution returns all or part of earned income, retirement or other fringe benefits to the institution.

24 Legal Expenses and Other Professional Services. This category includes the costs of legal and professional services performed by persons who are members of a particular profession or possess a particular skill and are not officers or employees of the institution. Examples of professional services include: legal services, payroll companies, accounting services, etc.

Additional guidance concerning professional service costs is contained in item 11, above; 2 CFR Part 225, Appendix B, 32; 2 CFR Part 230, Appendix B, 37; and 48 CFR §31.205-33.

(VIII I 24)

a Allowable Costs. With specific prior written approval:

(1) The sponsoring organization's cost to pursue administrative and judicial recovery of funds due from sponsored facilities when the costs are reasonable in relation to:

(a) The amount of the funds due; and

(b) The amount of the funds that can reasonably be expected to be recovered.

(2) The institution's costs for services performed by individuals who are not officers, employees or members of the institution when:

(a) The services are required in the administration of the Program;

(b) The costs are reasonable in relation to the services provided;

(c) The services have been properly procured;

(d) The terms of the contractual arrangement are adequate for the services required; and

(e) The costs are not contingent upon recovery of Program funds.

b Unallowable Costs.

(1) The cost of maintaining a legal staff to discharge general responsibilities; and

(2) The costs of legal services incurred in connection with organization and reorganization.

25 Lobbying and Advocacy Costs. This category includes costs for lobbying and advocacy, but not public relations (see item 3, above). Except as permitted in item a, below, lobbying and advocacy costs are unallowable. While unallowable lobbying and advocacy costs cannot be claimed for reimbursement or charged to the institution's nonprofit food service account, specific reporting and disclosure requirements apply (see item c 2, below).

a Allowable Costs.

(VIII I 25 a)

(1) The costs of responding to a documented request made by a member of Congress or the State legislature, a legislative body or subdivision or a cognizant staff member thereof for a technical or factual presentation of information on a topic directly related to the performance of the Program through hearing testimony (see item (2), below for travel costs), statements or letters, provided the information is readily available;

(2) Travel, lodging and meal costs are limited to individuals offering testimony at a regularly scheduled Congressional hearing pursuant to a written request for such presentation made by the Chairman or Ranking Minority Member of the Committee or Subcommittee conducting such hearing;

(3) The costs of lobbying to influence State legislation that would directly reduce the institution's Program costs or avoid a material impairment of the institution's authority or ability to fulfill Program requirements; and

(4) Legislative liaison activities when the activities are not carried on or in support of, or in preparation for prohibited lobbying activities.

b Unallowable Costs. All costs associated with:

(1) Any attempt to influence the award, amount, nature or renewal of a Federal award or grant;

(2) Any attempt to influence the outcome of any Federal, State, or local election, referendum, initiative or similar procedure;

(3) Any attempt to influence the introduction of Federal or State legislation through communication with any member or employee of Congress or State legislatures including attempts to influence State or local officials to engage in similar lobbying activity, or with any government official or employee in connection with a decision to sign or veto enrolled legislation;

(4) Any attempt to influence the introduction of Federal or State legislation or the enactment or modification of pending legislation by preparing, distributing or using publicity or propaganda or by urging members of the general public or any segment of the general public to contribute to or participate in any mass demonstration, march, rally, fundraising drive, lobbying campaign, letter writing or telephone campaign;

(5) Legislative liaison activities, including attendance at legislative sessions or committee hearings, gathering information regarding legislation and analyzing the effect of legislation, when such activities are carried on in support of or in knowing preparation for an effort to engage in unallowable lobbying;

(VIII I 25 b)

(6) Contributions to any political party, campaign, political action committee or other organization established for the purposes of influencing the outcome of elections, lobbying or advocacy;

(7) Membership costs, dues or fees paid to organizations that devote a substantial part of their activities to influencing legislation; and

(8) Costs of soliciting contributions for a prohibited lobbying activity.

c Documentation Requirements.

(1) All institutions must comply with the certification and reporting requirements contained in 7 CFR Part 3018.

(2) 2 CFR Part 225, Appendix B, 24; 2 CFR Part 230, Appendix B, 25; and 48 CFR §31.205-22 should be consulted for additional information on recordkeeping and reporting requirements.

26 Management Studies. Management studies are used to identify Program weaknesses, target unserved eligible populations or improve Program administration or operations.

a Allowable Costs. With specific prior approval, the cost of studies directly related to the Program that is performed by entities other than the institution itself.

b Unallowable Costs

(1) Costs of studies performed by the institution's officers, employees or family members, thereof; and

(2) Costs of studies for non-Program purposes, including studies to assess the general operation or management of the institution.

27 Materials and Supplies. This category includes durable supplies (cell phones, etc.) and expendable materials and supplies (pens, paper, ink cartridges, etc.) which do not meet the definition of equipment.

a Allowable Costs.

(1) Costs for durable supplies at the time of purchase;

(VIII I 27 a)

(2) Costs of expendable Program materials and supplies actually used within three months or less of the time of purchase; and

(3) When expendable material and supply purchases exceed more than three month's usage, 90 days, allowable material and supply costs are limited to the cost of the items actually used for the Program during the month.

b Unallowable Costs.

(1) Materials and supplies used by the institution and individuals for non-Program purposes.

c Documentation Requirements.

(1) Regular physical inventories of materials and supplies may be required by the State agency. Exhibits E, F, G and H of this Instruction can be used to calculate the cost of materials and supplies used and to maintain material and supply inventories and schedules.

(2) State agencies may establish specific prior written approval requirements for durable supply acquisitions.

28 Meetings and Conferences. Meetings and conferences include Federal, State, local, national or regional child and adult care conferences. Meeting and conference costs do not include participant training or other participant support costs. (See item 30, below.) The State agency may limit the number of the institution's staff at any meeting or conference. When only minimal costs will be charged to the CACFP, the State agency may waive the prior approval requirements of item a, below.

a Allowable Costs.

(1) With prior approval, the travel (see item 39, below), and registration fees for attending meetings and conferences devoted solely to the CACFP.

(2) With specific prior written approval, the allocated share of travel and registration fees when the CACFP is only a portion of a larger child and adult care related agenda.

b Unallowable Costs.

(1) Costs for attending or hosting meetings or conferences that are:

(VIII I 28 b (1))

- (a) Solely for non-CACFP issues;
- (b) To conduct the general business of the institution (see item 20, above);
- (c) To engage in or prepare for prohibited lobbying activities (see item 25, above);
- (d) Primarily for social or entertainment activities (see item 15, above); or
- (e) Related to fundraising (see items 3 b(3) and 22, above).

29 Membership, Subscriptions, and Professional Organization Activities. Membership costs in civic, business, technical and professional organizations and subscriptions to professional and technical periodicals are included in this category.

a Allowable Costs.

- (1) Membership fees and annual dues for the institution's membership in business, technical and professional organizations related to the Program;
- (2) Membership fees and annual dues for one individual membership per institution in business, technical and professional organizations related to the Program when the organization will only accept individual and not institutional membership;
- (3) Costs for the institution's subscription to periodicals related to the Program;
- (4) With specific prior written approval of FNSRO, costs of public and nonprofit institution memberships in civic or community organizations; and
- (5) With prior written approval from the State agency, membership in discount warehouse buying clubs, provided the institution has offered sufficient justification that the membership would be used strictly for the organization and would save the Program money.

(VIII I 29)

b Unallowable Costs

- (1) The costs of individual memberships in professional organizations but these costs may be allowable for employees as fringe benefits; see item 23 g, above;
- (2) Proprietary institution membership costs in civic or community organizations;
- (3) All other costs of membership in allowable organizations;
- (4) Costs of individual or personal subscriptions (see item 23 g, above); and
- (5) All costs of membership or participation in social organizations, organizations whose primary purpose is soliciting funds for lobbying activities, or organizations devoted to lobbying.

30 Participant Training and Other Participant Support Costs.

Participant training and support costs are the institution's costs for conducting training and providing a fair hearing to facilities for actions of the sponsoring organization that adversely affect the facilities' CACFP participation or funding. Child care center and day care home personnel required to attend training who use substitute care providers may claim meals for reimbursement when the meals served by substitute care providers meet all Program requirements. (See *Advertising and Public Relation Costs* at VIII I 3 for more information).

a Allowable Costs.

- (1) Training-administrative costs. With prior approval, the following administrative costs for required pre- and post-Program approval training of facility personnel:
 - (a) Rental costs of properly procured third-party meeting and conference room space;
 - (b) Fees for speakers, who are not employees, officers, directors or trustees or immediate family members, thereof, when the presentation is directly related to Program requirements;
 - (c) Costs of child care services provided for attending facility personnel;

(VIII I 30 a (1))

(d) Costs for meals and nonalcoholic beverages served to participants but not to guests, when Program training is presented concurrent with the meal service;

(e) Materials and supplies that are not included in Materials and Supplies (item 27, above), or Publication, Printing or Reproduction Costs (item 33, below); and

(f) Costs incurred for minor amounts of time spent on participant training on non-Program requirements or subjects when the costs are incidental to Program training and not otherwise unallowable.

(2) Training-operating costs. With prior approval, the following operating costs for child or adult care center Programs:

(a) The cost of substitutes for child or adult care center employees required to attend training conducted during the center's established hours of Program operations for center Programs; and

(b) Travel and transportation costs that meet the requirements of this Instruction for child or adult care center employees required to attend training.

(3) Facility appeal costs. With prior approval, the administrative costs of the sponsoring organization's system for hearing appeals of actions taken by the sponsor that affect a facility's Program participation or funding.

b Unallowable Costs.

(1) Costs for motivational speakers;

(2) Costs of social events, entertainment, flowers, table decorations, alcoholic beverages, door prizes and gifts;

(3) Costs for providing substitutes for day care home providers when training is conducted during the facilities' established hours of Program operations;

(4) Travel and transportation costs for day care home providers to attend training; and,

(5) All other participant support costs.

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(VIII I)

31 Political, Partisan and Legislative Costs. All political, partisan and legislative expenses, including salaries and other expenses of local governmental bodies such as county supervisors, city councils and school boards are unallowable.

32 Proposal Costs. Proposal costs are the costs of preparing proposal submissions for grants or projects.

a Allowable Costs. With specific prior written approval, the costs of preparing proposals on potential FNS Child Nutrition Program grants.

b Unallowable Costs.

(1) The costs of preparing applications for participation in other FNS Programs;

(2) The costs of preparing all other grant applications or proposals; and

(3) Unless specifically required by the terms of a Federal grant or project agreement, all costs of performing under the grant or project awarded as a result of proposal submissions.

33 Publication, Printing and Reproduction. This category includes the costs for in-house and outside publication, printing and reproduction costs not included elsewhere in this Instruction.

a Allowable Costs. All allowable costs require prior approval and are limited to:

(1) The direct costs for publication, printing and reproduction of materials related solely to the Program; and

(2) The allocated share of direct costs when Program and non-Program purposes are benefited.

b Unallowable Costs.

(1) All direct publication, printing and reproduction costs when they are included in the institution's approved or indirect cost rate agreement as indirect costs; and

(2) Costs for non-Program purposes.

(VIII I)

34 Purchased Services - Other. This category includes the costs of services, excluding Professional Services (see item 24, above), required for Program operations that are not included elsewhere in this Instruction.

a Allowable Costs.

(1) With prior approval:

(a) The costs of the maintenance, repair or upkeep of administrative and food service equipment that neither adds to its permanent value nor prolongs its expected useful life but keeps it in an efficient operating condition, provided the institution incurred these costs in arms-length transactions; and

(b) The costs of utilities, purchased security and janitorial service, etc., not included in space costs or labor compensation costs.

(2) With specific prior written approval:

(a) The cost of all services obtained through less-than-arms-length transactions;

(b) Maintenance and service repair contracts on Program equipment; and

(c) All other purchased service costs needed for Program operations.

b Unallowable Costs.

(1) Costs that prolong the useful life of equipment or facilities, but these costs may be eligible for treatment as depreciation expense or allowed as a direct expense. (See items 13, 16 and 17, above);

(2) Any share of purchased service costs incurred for non-Program purposes; and

(3) Costs from less-than-arms-length transactions that are not fully disclosed.

35 Records Retention Costs. Costs for supplies, storage and maintenance of records necessary for Program administration are allowable.

36 Rental Costs. Costs in this category include lease costs for space, facilities, vehicles and equipment for use in the Program. The costs resulting from

(VIII I 36)

less-than-arms-length transactions and lease arrangements that result in ownership interests, however represented, are limited. (See item d, below.) Rental fees must be allocated between Program and non-Program use to obtain the portion that benefits the Program. (See item c(2), below.)

a Allowable Costs

(1) Space and facilities:

(a) Private and public buildings and facilities.

The institution's cost for the Program share of rental costs of space in a building owned by a private third party when properly procured and a bona fide arms-length written rental agreement exists between the institution and the lessor;

(b) Publicly owned facilities. The institution's cost for the Program share of costs for publicly owned buildings newly occupied on or after October 1, 1980, where "rental rate" systems or equivalent systems are used which adequately reflect actual costs;

(c) The Program share of maintenance and custodial costs when included in rental charges; and

(d) Private residence. The Program share of space costs in a private residence to the extent that the rental rate is reasonable and a bona fide arms-length rental agreement exists (see item 17(a)(2), above, for space costs of private residences in a less-than-arms-length transaction).

(2) Vehicles and equipment:

(a) The Program share of rental costs for equipment and vehicles owned by third parties that are leased by the institution for Program purposes when properly procured and a bona fide arms-length written rental agreement exists.

b Unallowable Costs.

(1) Rental costs of space, facilities, equipment or vehicles leased by individuals (see item 39 a(2), below for information on mileage allowances for personally leased vehicles);

(2) The allocated share of the rental costs of space, facilities, vehicles and equipment used by officers, directors, consultants, trustees, employees or their family members for personal purposes;

(VIII I 36 b)

(3) The allocated share of rental costs for space, facilities, vehicles and equipment used by the institution for non-Program purposes;

(4) The portion of the rental fee that includes costs originally financed by the Federal Government for purchase or construction;

(5) Direct rental charges when the rental costs are treated as indirect costs in the institution's indirect cost rate agreement;

(6) Leasing costs and a mileage allowance for the same vehicle; and

(7) Charging lease fees and depreciation or a use allowance for the same equipment, facilities or vehicles.

c Reasonableness and Allocation Requirements.

(1) Factors in determining reasonableness.

(a) For all rental costs:

(i) The type, life expectancy, condition and value of the property or item;

(ii) The compliance of the contractual documents to applicable procurement requirements; and

(iii) The benefits received by the Program in relation to the cost to the Program.

(b) For space costs in private residences and public buildings not using rental rate systems.

(i) The rental costs of comparable property; if any; and

(ii) The availability of commercial rental property in the area.

(2) Allocation. When charged as a direct cost, the rental costs for facilities, equipment and vehicles used for Program and non-Program purchases must be allocated between Program and non-Program use. The following procedures can be used to identify the maximum Program share of the direct costs for space, equipment and vehicles.

(VIII I 36 c (2))

(a) Space costs.

(i) The rental costs must first be allocated by the ratio of the square footage of Program space to:

(a) The total square footage of the rented space in commercial buildings; or

(b) The total square footage of living space in a private residence.

(ii) For all space and facilities, including a private residence, the cost of the Program rental space must be allocated by the ratio of the actual number of hours of Program use to the total number of hours that space is used.

(iii) For all allocated space costs, the State agency must establish the format, method and frequency for documenting the actual time and space used for Program and non-Program purposes.

(iv) For all allocated space costs, when the costs of utilities are not included in the rental fee, the costs can be charged as a Purchased Service (see item 34, above) according to the same allocation procedure used to charge the rental fee itself.

(b) Equipment and vehicles:

(i) For equipment and vehicles, the Program rental cost must be allocated using a base approved by the State agency that results in a fair and equitable assignment of cost to the Program; and

(ii) See item 39, below for vehicle operating costs, such as fuel costs, parking and tolls that are not included in the leasing fee.

d Special Lease Arrangements. The following four types of lease arrangements require special consideration and specific prior written approval. Except for costs under Lease with Option to purchase (see item 36(d) 4, below), all Program costs under these special lease arrangements are limited to the costs that would have been allowed had the institution purchased or continued to own the item on the date the lease was executed. Institutions are not permitted to charge to the Program any portion of the rental fee that exceeds that amount.

(1) Capital (Material equity) leases. Costs charged to the Program under rental/lease arrangements that create a material equity (an ownership

(VIII I 36 d (1))

interest in the leased property) cannot exceed the allowable costs that would have been permitted had the institution purchased the item on the date the lease was executed. A material equity is created when:

(a) The lease/rental agreement cannot be canceled; requires the item to be purchased if the lease/rental agreement is canceled; or is cancelable only upon the occurrence of some remote contingency;

(b) The institution has the right to purchase the item at the end of the lease/rental term for a price that appears to be substantially below the probable fair market value of the item (commonly called a lease with a bargain purchase option);

(c) Title to the item passes to the institution, without its exercising a purchase option, at some time during or after the lease period;

(d) The term of the lease (initial term plus periods covered by bargain renewal options, if any) is equal to 75 percent or more of the economic life of the leased item; or

(e) A specific portion of the lease/rent payments is applied to the purchase price of the item, whether or not the purchase option is exercised.

(2) Sale-with-lease-back. Sale-with-lease-back arrangements occur when an item is sold and then leased back to the seller or an affiliate of the seller. The seller may be an individual or a business. Allowable lease costs under a sale-with-lease-back arrangement are limited to the amount that would result had the institution continued to own the item.

(3) Less-than-arms-length transactions. Costs under less-than-arms-length arrangements, no matter how represented, may not exceed the amount that would have been allowed had the item been owned by the institution. All transactions between related parties are less-than-arms-length.

(a) Allowable lease costs are limited to:

(i) Space and Facilities. The amount that results from applying 30-year life expectancy to the property's acquisition cost less the value of land;

(ii) Equipment. The amount that results from applying 15-year life expectancy to the acquisition cost of equipment, excluding automobiles and ADP equipment; and

(VIII I 36 d (3)(a))

(iii) Automobiles and ADP equipment.

The amount that results from applying 5-year life expectancy to the acquisition cost of automobiles and ADP equipment.

(4) Lease with option-to-purchase agreements. These agreements do not create a material equity, but do permit the lessee the opportunity to purchase an item. Costs for equipment or vehicles, but not space, facilities or land, in this type of lease arrangement are allowed with specific prior written approval when:

- (a) The State agency would approve the direct expensing of the same item;
- (b) The costs are allocated between Program and non-Program use;
- (c) The lease agreement is not a component of a sale-leaseback or related party agreement;
- (d) The terms of the lease agreement do not create a material equity in the property leased; and
- (e) The costs are reasonable given the total costs that will be paid by the institution under the lease with option to purchase agreement when compared to rental without the purchase option and the costs of financing the purchase of the item.

37 Taxes. This category includes sales taxes, taxes on goods and services produced by the institution and assessments levied by Federal, State and local governments.

a Allowable Costs.

Taxes or payments in lieu of taxes that the institution is legally required to pay as a result of operating the Program.

b Unallowable Costs.

- (1) Personal income taxes;
- (2) Corporate income taxes;
- (3) Taxes resulting from non-Program operations;

(VIII I 37 b)

(4) Special assessments on land that represent capital improvements;

(5) Any taxes from which exemptions are available, whether or not the exemption is exercised; and

(6) Penalties and interest payments resulting from late filings or payments except when these costs result from complying with specific CACFP provisions or written instructions from FNS.

38 Termination Costs. Costs in this category result when an institution voluntarily (termination for convenience) or involuntarily (termination for cause) ceases Program operations. (See IX D 9, below for close out procedures.)

a Allowable Costs.

(1) With specific prior written approval, the institution's necessary and reasonable costs of ceasing CACFP operations. Examples of allowable termination costs include:

(a) Costs of transferring equipment and supplies with a residual Federal interest (per 7 CFR §3016.32(e), §3016.33(b), §3019.34(g), or §3019.35 (a), as applicable) to the State agency or another Child Nutrition Program participant;

(b) The CACFP share of termination fees for unexpired Program space and equipment leases;

(c) Necessary and reasonable accounting, clerical and administrative salary and benefit costs resulting from completing CACFP close out activities, i.e., notifying sponsored facilities, preparing a final reimbursement claim and issuing final payments to sponsored facilities; and

(d) Reasonable costs for storage, transportation, protection and disposition of CACFP records.

b Unallowable Costs.

(1) Non-CACFP costs;

(2) Costs for items reasonably usable in the institution's other activities;

(3) Cost for losses on the disposal of corporate assets;

(VIII I 38 b)

(4) Estimated costs; and

(5) All costs resulting from the negligent or willful failure of an institution to discontinue incurring such costs.

39 Travel. Travel costs are expenses for transportation, lodging, subsistence and related costs for employees, officers, directors or trustees performing Program work while in travel status. (See item 23 d, above for stipends paid to officers and board members for attending certain board meetings.)

a Allowable Costs. Costs for Program travel require prior approval and may be charged on an actual, per diem or mileage basis provided that the method used results in charges consistent with those normally allowed by the institution in its non-Program operations. The 2 CFR Part 225, 2 CFR Part 230, and 48 CFR §31.205-46 should be consulted for additional information. For the most current Federal per diem rates refer to <http://www.gsa.gov/portal/category/100120> and for the most current Federal mileage information refer to <http://www.gsa.gov/portal/content/100715>

(1) General.

(a) Proprietary institutions. Mileage, lodging, meals and incidental travel expenses of proprietary institutions are generally limited to the rates prescribed by the GSA Federal Travel Regulations. (See 48 CFR §31.205-46.)

(b) Nonprofit and public institutions. State agencies cannot require that institutions use the State, Federal GSA or IRS mileage and travel rates instead of the rates the institution uses for non-Federally funded travel. However, State agencies can limit the amounts charged for Program mileage and other Program travel costs of a particular institution when:

(i) The amount requested by the institution is unreasonable;

(ii) The State agency determines through reviews, audits or other information that the requested rate will divert needed financial resources from activities required to meet Program requirements or maintain effective and efficient Program operations; or

(iii) The State agency cannot evaluate the reasonableness of the institution's established rates and travel policies because the institution administers only Federally-funded Programs or the institution's primary source of revenue is from Federally-funded Programs.

(VIII I 39 a)

(2) Mileage costs. When an institution owns or leases vehicles or its employees, officers, directors or trustees use personally owned or personally leased vehicles for Program purposes, the institution may use actual costs or a mileage allowance.

(a) Actual costs. The Program share of costs for operating the vehicle including gas, oil, routine maintenance and as applicable, depreciation, use allowance or leasing fee;

(b) Mileage allowance. A mileage allowance is the full amount allowed for the costs of operating the vehicle, excluding the driver's salary, parking and toll fees. The institution may use either:

(i) The State agency approved mileage allowance paid to the employee, officer, director or trustee for Program use of a personally owned or personally leased vehicle; or

(ii) For vehicles owned or leased by the institution, the same allowance used by the institution for reporting business vehicle costs for Federal tax purposes.

b Unallowable Costs.

(1) The costs of personal travel;

(2) The costs of non-Program travel including non-Program travel incidental to Program travel;

(3) Reimbursement for the costs of commuting to and from work; and

(4) A mileage allowance when actual operating costs (fuel, insurance, maintenance, etc.), depreciation, use allowance or a lease fee is charged for the same vehicle.

c Documentation Requirements.

(1) For all travel and transportation costs:

(a) The date and times of day for each trip charged to the Program;

(b) The traveler's name;

(VIII I 39 c (1))

- (c) The origin and destination of each trip;
- (d) Lodging, meal and common carrier receipts,
as applicable;
- (e) The reason for each trip;
- (f) When the trip includes Program and non-Program purposes, all non-Program lodging, mileage and other travel costs must be identified and allocated between the Program and non-Program functions; and
- (g) A responsible official of the institution must certify in writing that records documenting all travel costs and mileage claimed for Program purposes have been reviewed for reasonableness and allowability.

(2) Mileage costs. In addition to the information identified in item c (1) above, the following documentation is also required for mileage costs.

- (a) Miles driven;
- (b) Receipts for all expenses charged as actual costs;
- (c) As applicable, depreciation schedules, use allowance schedules and bona fide third party lease agreements; and
- (d) At the discretion of the State agency, odometer readings.

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IX BASIC GUIDELINES FOR PAYMENT AND USE OF CACFP FUNDS

CACFP reimbursement is computed on a year-to-date basis using monthly data for all institutions participating in the CACFP. The CACFP regulations establish two methods for reimbursing participating institutions, the categories of institutions to which these methods must be applied, and specific procedures for States electing to issue advance payments. The CACFP regulations further identify factors which must be considered in determining maximum allowable reimbursement and the proper use of nonprofit food service account funds. State agencies must establish payment and financial management systems that reflect these requirements.

A Reimbursement Methods. The two methods of reimbursement used in the CACFP are:

1 Rate Based Reimbursement.

Reimbursement is computed using the number of reimbursable meals by type (breakfast, lunch, supper, and snacks) served to eligible participants in approved centers or day care homes participating during the month multiplied by the applicable income eligibility based rate per meal.

Generally, the State agency decides how to reimburse participating institutions by establishing payment and financial management systems.

2 Cost Based Reimbursement.

Reimbursement is computed using the lesser of net allowable costs or the results of the rate based computation. When the cost based reimbursement method is used, the total CACFP payments made to the institution during the Federal fiscal year cannot exceed the total net CACFP costs incurred for that fiscal year, less income to the Program. (See D 6, below and Exhibit J for more information on income to the Program.)

B Applicable Reimbursement Methods.

The CACFP regulations require that State agencies reimburse participating institutions using specific methods.

1 Sponsoring Organizations of Day Care Homes. Reimbursement for sponsoring organizations of homes may be computed as follows:

a Administrative cost reimbursements are determined by multiplying the number of day care homes submitting a claim for reimbursement to the sponsoring organization during the month by the appropriate, annually adjusted administrative reimbursement rate, as described at 7 CFR §226.12(a). Sponsoring organizations may carry over to the next Federal fiscal year a maximum of 10 percent of administrative reimbursements earned but not used in the current fiscal year. Any remaining unspent sponsor administrative funds over and above the 10 percent limit must be returned to the

Sponsoring organizations, independent centers, and provider and sponsored center payments must be reimbursed through specific methods.

(IX B 1 a)

State agency. State agencies should encourage sponsoring organizations to adopt first-in-first-out accounting procedures to ensure that funds carried over are the first funds spent in the succeeding fiscal year. Sponsoring organizations are not required to carry over any unspent funds but may at their option, return them to the State agency.

b The State agency may, at a sponsoring organization's request, calculate administrative payments based on the sponsor's actual expenses. Under this option, the total reimbursement provided during a Federal fiscal year may not exceed the reimbursement that would have been earned under the "homes times rate" calculation. Sponsoring organizations that choose this option will not be able to carry over funds into the next fiscal year. The State agency is not required to provide sponsoring organizations with this option.

c Some sponsoring organizations, such as those associated with the military, may have other sources of funds and may wish to decline administrative reimbursement entirely. However, State agencies should review the sponsoring organization's budget to ensure that the sponsoring organization has the financial capability to properly administer the Program without the administrative funds.

2 Center Programs. State agencies may elect to compute reimbursement for center Programs using one of the following methods.

a The rate based reimbursement method applied to:

(1) The number of meals by type served to participants by income eligibility (Actual count); or

(2) The total number of meals by type served during the reporting period to eligible participants times a claiming percentage or blended rate (7 CFR §226.2).

b The cost based reimbursement method using the lesser of the rate based computation or net allowable operating and administrative costs.

(1) Allowable center costs are limited to:

(a) The net cost of meals that meet the regulatory requirements that are served to eligible participants;

(b) The net cost of meals served to Program adults; and

(c) Net administrative costs for the institution's allowable expenses for planning, organizing and managing a Program.

(IX B 2 b)

- (2) Unallowable center costs for claiming and computing reimbursement include:
- (a) The cost of meals that do not meet regulatory requirements;
 - (b) The cost of excessive second meals even when served to participants;
 - (c) The cost of meals served to nonparticipants;
 - (d) The cost of a la carte foods;
 - (e) The cost of meals served to non-Program adults;
 - (f) All administrative and operating costs identified as unallowable in Section VIII above; and
 - (g) All non-CACFP food service operating and administrative expenses.

(3) Costs that are not allowed for claiming and computing reimbursement may still be allowable nonprofit food service account expenses. (See item VI C, above.)

3 Provider and Sponsored Center Payments. Sponsoring organizations are required to make payments of Program funds to day care homes and sponsored centers within 5 working days of receipt from the State agency (7 CFR §§226.16(g) and (h), respectively) consistent with the distribution procedures in the approved management plan.

a Timely disbursement. To meet the requirements for timely disbursement, a sponsoring organization must:

- (1) Issue payment to the facilities for which the advance or reimbursement was claimed;
- (2) Issue payment to the facilities equal to the full amount of the food service advance or reimbursement payment received, except for certain allowable reductions and increases (see item c, below); and
- (3) Issue payment to the facilities by mailing, electronic funds transfer or personal delivery within the five working day period.

(IX B 3)

b Facility Funds Integrity. Whether sponsoring organizations use a separate bank account for facility payments or a commingled account, the integrity of the facility payments must be maintained at all times. At a minimum, this requires that:

(1) Sponsoring organizations using a separate bank account must transfer the full amount of the facility payments into that account no later than the same day the facility payments are mailed or for EFT payments, the full amount of the facility payments must be transferred at least 1 working day before the EFT payments are issued.

(2) Funds retained in a separate bank account cannot be withdrawn, transferred or otherwise removed from the account except to:

(a) Liquidate facility payments;

(b) Return the amount of excess earned interest

(see item D 7, below); or

(c) Assign the amount of allowable earned interest into another Program account (see D 7, below).

(3) Sponsoring organizations using a commingled account must maintain funds in the account that are at least equal to all un-liquidated facility payments and any other un-liquidated checks or other disbursements, such as automatic debits for bank services, etc.

(4) In all cases, sponsoring organizations must establish and maintain controls that prevent the use of the facility payments for any purpose other than liquidating facility payments and properly assigning earned interest as permitted by item D 7, below. This includes using facility payments during the “float period” i.e., the time between when the institution receives the funds and when the checks are presented to the bank for payment; and

(5) Sponsoring organizations must maintain documentation that the integrity of facility payments is maintained at all times. This includes:

(a) Facility reconciliation reports (see item E 2, below);

(b) The date and amount of advance and reimbursement funds claimed and received;

(IX B 3 b (5))

(c) If using a separate facility bank account:

(i) The date and amount of each transfers to the account, and

(ii) A bank reconciliation conducted at least monthly that identifies liquidated facility payments by check number or EFT account number and all outstanding facility payments by check number and facility name.

(d) If using a commingled account, a bank reconciliation report conducted at least monthly that separately identifies:

(i) Each deposit and reduction to the account by amount, date and source; and

(ii) The liquidated and un-liquidated facility payments and all other liquidated and outstanding obligations against the account separately identified by check number, name and amount.

c Adjustments to Facility Payments. In certain cases, sponsors of facilities may reduce or increase the amount of the facility's payment. These cases are limited to:

(1) Recovery of an overpayment from a facility. Facility overpayments can only be recovered from the facility that owes the money. The amounts recovered must be returned to the State agency unless the sponsoring organization has used non-Federal funds to repay the State agency and is recouping these funds from the facility's CACFP payment;

(2) Advanced funds. The full amount of the reimbursement due to the facility must be reduced by the amount of any payment advanced for that same period plus any outstanding advance from a prior period;

(3) State agency adjustments. When the State agency reduces the amount of advance or reimbursement claimed because of specific facility errors or ineligibility, the sponsor must make corresponding adjustments only to that facility's payments;

(4) Revised claims. A sponsoring organization may aggregate minor amounts of a facility's payments for revised claims and issue a single check or add the amounts to the facility's next reimbursement or advance funds payment with the specific prior written approval of the State agency. The State agency may waive specific prior written approval by establishing a written policy that incorporates the

(IX B 3 c (4))

State agency's definition of minor amounts, the maximum amount that can be aggregated and the timing and method for issuing the facility its aggregated payment;

(5) Food service costs incurred by the sponsoring organization. The full amount of reimbursement due to the facility can be reduced by the amount equal to the food service operating costs incurred by the sponsoring organization on behalf of the facility with the facility's written consent;

(6) Although sponsoring organizations of centers are not automatically entitled to retain and use any funds for administrative expenses, a sponsoring organization may retain a portion of the reimbursement for its actual net administrative costs in accordance with the management plan approved by the State agency. However, on a Federal fiscal year basis, the amount retained cannot exceed 15 percent of the actual meal reimbursement or the approved budget level (see item D 2, below for more information);

(7) Cost based reimbursement to sponsored centers. In States that reimburse on the lesser of meals time rates or costs, payments to each sponsored center cannot exceed the net allowable Program costs at that facility during the fiscal year. When certain sponsored centers have high costs while others have low costs, the amount of reimbursement earned may exceed actual net allowable Program costs in the lower cost sponsored centers. In these situations, the sponsoring organization must limit reimbursement to these lower cost centers to net allowable costs and distribute the excess earnings to the higher cost centers; and

(8) Rate based reimbursement to sponsored centers. In States that use rate based reimbursement, payments to sponsored centers cannot exceed the rates times the number of meals documented and claimed on behalf of each facility during the fiscal year. Sponsoring organizations of these centers may vary the amount of reimbursement paid to sponsored facilities up to the maximum allowed.

C Advance Payments. States that elect to issue advance payments can offer advances to all institutions or limit advance payments to only certain institutions. In a State electing to issue advances, an institution may choose to receive none, all or only a portion of the amount of advance funds payable.

The State agency decides whether to offer advance payments.

1 Timing. An advance payment must be issued to the institution by the first day of each month for which the advance is payable.

a State agencies cannot issue more than three advances without validating the institution's reimbursement claim for the first month's advance.

(IX C 1 a)

(1) State agencies establishing shorter deadlines for claims submission (7 CFR §226.10(e)) are not required to issue three advances before validating the reimbursement claim for the first month's advance.

b Sponsoring organizations accepting advance payments for sponsored facilities must issue these funds as an advance payment to the facilities within 5 working days of receipt consistent with the procedures identified in item B 3, above.

2 Amount. The monthly amount of the advance funds issued cannot exceed one month's anticipated earnings. An institution may always request less than the full amount of advance to which it is entitled.

a State agencies must use the most recent, reliable data when determining the amount of the advance to issue to each institution. Factors to consider include:

- (1) Prior reimbursement claims;
- (2) Fluctuations in enrollment; and
- (3) Review and audit results.

b State agencies must adjust each institution's advance payments to reflect the institution's current level of claims and outstanding advance fund balances. The adjustment is computed using one of these methods:

(1) Monthly comparison. This method uses the reimbursement earned on a validated claim as the amount of the each month's outstanding and subsequent advances. The difference between the amount of each month's outstanding advance and the amount that should be outstanding is computed. The differences are then summed. When a net difference exists, the State agency must adjust future advances to reconcile reimbursement earnings and advance payments. If an overpayment exists, the State agency may also demand full repayment. This method is best used with institutions that have relatively stable reimbursement earnings or are experiencing a consistent decline in reimbursement earnings.

(2) Average month. Using this method, the State agency computes the average of the outstanding advances and compares the result to the average monthly reimbursement earned year to date. Advance payments are adjusted to reconcile the amount of any increase or decrease. If an overpayment exists, the State agency may demand repayment. Since this method uses averages, it is less sensitive to monthly variations in reimbursement earnings and will result in more uniform advance payments to institutions that experience significant variations in monthly reimbursement earnings or institutions experiencing a consistent increase in earnings.

(IX C 2)

c Adjusting reimbursement payments for advances.

Regardless of the method used to compute adjustments to advance payments, on a Federal fiscal year basis, State agencies must deduct the amount of outstanding advances from earned reimbursement payments to reconcile and compute the net Federal fiscal year amount of reimbursement payable to the institution.

d Facility advances. Sponsoring organizations accepting advances on behalf of sponsored facilities must establish and comply with procedures that ensure that total payments, including advance payments, made to each facility for each fiscal year do not exceed the amount of funds to which the facility is entitled. To meet this requirement, institutions must maintain procedures consistent with items 2 b and c, above for advance payments issued to facilities.

3 Prohibited practices. Restrictions on the issuance and use of advance funds apply to both State agencies and sponsoring organizations. Prohibited practices include:

a Issuing an advance payment equal to more than one month's net adjusted earnings;

b Failure to reconcile advances and earned reimbursement;

c On a Federal fiscal year basis, failing to adjust reimbursement payments for outstanding advance payments;

d Issuing a fixed number of advances to an institution and allowing the institution to retain the advances without offset to reimbursement on a Federal fiscal year basis, also known as "floating advances"; and

e Using advance payments to reimburse facilities for meals served in prior periods except as permitted by 7 CFR §226.16(g). Sponsoring organizations receiving food service advance payments must issue the funds, within the required 5 working day time frame, as an advance payment to facilities for the month for which the advance was provided.

D Other Factors.

1 Adult Meal Costs. Except for meals served to participating adults in approved adult day care Programs, meals served to adults cannot be claimed for reimbursement. However, in certain cases, the costs of adult meals are allowable.

a Program adult meals. The costs of meals served with or without charge to Program adult, are allowable nonprofit food service account costs, but the meals themselves are not eligible for reimbursement.

(IX D 1)

b Meals Served to Non-Program Adults. The costs of meals served to non-Program adults are unallowable and the meals themselves may not be claimed for reimbursement.

(1) Accounting for Non-Program adult meal costs. When the institution does not operate a food service principally for the benefit of enrolled participants or operates in a State that reimburses the lesser of meals times rates or cost, the institution must use one of the following methods to account for non-Program adult meal costs:

(a) Exclude both non-Program adult meal payments and the full cost of non-Program adult meals from Program food service costs; or

(b) Report payments received for non-Program adult meals as Program income and include the cost in Program food service costs.

(i) When the charge for a non-Program adult meal is less than the full cost of producing the meal, the shortage is not an allowable Program cost.

(ii) When the amount paid for the meal exceeds the full cost of producing the non-Program adult meal, the excess is Program income and must be used in the nonprofit food service.

c Meals Served to Eligible Adult CACFP Participants. The cost and the meals served to adult CACFP participants, who assist in the meal service, can be claimed for reimbursement as Program meals.

2 Center Administrative Costs.

a Sponsoring organizations of centers. The State agency must limit the amount of reimbursement payments that can be applied to administrative costs for sponsoring organizations of center Programs to the lesser of 15 percent of the total reimbursement payments received or net allowable administrative costs. The State agency may waive the 15 percent limitation upon approval of the center sponsor's justification that the organization requires funds in excess of the 15 percent limitation to pay for Program administrative expenses. Further, State agencies must limit the costs approved in the center sponsor's administrative cost budget to not more than 15 percent of the anticipated reimbursement payments for the budgeted period or the amount of the

Meals served to nonparticipating adults cannot be claimed for reimbursement, but the cost of producing them may be an allowable charge to the institution's nonprofit food service account.

(IX D 2 a)

approved waiver. This limitation applies to sponsors of affiliated and unaffiliated centers.

b Independent centers. State agencies may limit the amount of reimbursement payments that can be used for administrative costs in independent centers, even when cost is not used to compute reimbursement.

3 Net Costs. Allowable costs must be net of all applicable credits and reductions. All credits, reductions and offsets to costs must be documented and subtracted from the gross allowable costs when computing the net allowable costs. Net costs are used to determine:

a Maximum allowable reimbursement when cost is used to compute reimbursement; and

b The institution's compliance with nonprofit food service account requirements.

4 Non-Profit Food Service Account. All institutions must maintain a nonprofit food service account. (See item VI, above, for more information on determining the nonprofit food service status and monitoring of nonprofit food service accounts.)

5 Costs Funded From Other Sources and Under Recovery of Costs. Institutions cannot claim reimbursement for CACFP costs that are funded by another source (claiming the same cost twice), nor can they charge the CACFP for costs incurred under other Federal Programs in excess of the grant payments under those Programs (under recovery of costs) except for the following situations:

a The costs are funded by bona fide third party loans or other non-Program funds on a temporary, non-continuing basis to meet short term cash flow needs of the CACFP;

b Claiming the same cost to the CACFP and another Federal grant Program is permitted by Federal statute, Federal regulation or the terms of a Federal interagency agreement; and

c The terms of a Federal statute, Federal regulation or the terms of a Federal interagency agreement permit charging an under recovery of costs to another Federal grant. In some institutions (Head Start, for example), a priority for the use of Federal funds has been established by the Federal grantor agencies. Under this type of priority, CACFP funds are used first in meeting the institution's food service costs, while the other Federal agency's grant funds are used to pay for any remaining food

(IX D 5 c)

service costs. However, CACFP funds cannot be used to pay for the same costs funded with the other Federal agency's funds.

6 Income to the Program. Income to the Program occurs in two categories: Program income and other income. All income to the Program must be retained and used only in the institution's Program food service.

a Program Income. Program income is the gross income earned from activities supported by the Program. When the institution's nonprofit food service includes all of its food service activities, Program income is generated by the operation of any aspect of that food service. When the institution's Program food service is limited to the CACFP, Program income is limited to the income that results from operating the CACFP. If an institution incurs costs to produce the Program income but does not charge these costs to the Program, these costs may be subtracted from gross income to determine net Program income.

(1) Program income is limited to:

(a) Participant payments for meals in institutions which operate pricing Programs;

(b) Payments received from food sales to adults when the cost of the adult meals is not deducted from total operating costs (see item D 1, above);

(c) Revenue from non-Program operations when a separation of Program and non-Program food service is not appropriate;

(d) Proceeds from the disposition of real and nonexpendable personal property acquired with FNS funds. When the property is sold, no longer available for use in FNS sponsored activities, or used for purposes not authorized by FNS, FNS's equity in the asset will be refunded in the same proportion as its participation in the cost. Due to the definition of equipment (\$5,000 or more per unit), the date of acquisition will determine if the proceeds are Program income (disposition of equipment) or other income (disposition of supplies). For public institutions, the date of change is October 1, 1995 and for nonprofit institutions the date of change is October 1, 1998; and

(e) Royalties and other income earned from the sale or licensing of copyrighted work developed under the Program. Examples include license fees for software developed to prepare Program claims for reimbursements, gross income from the sale of cookbooks prepared for use in the Program, training materials and rental fees or income from videos developed with Program funds.

Program income is the gross income earned from activities supported by CACFP.

(IX D 6)

b Other Income includes other funds that result from Program operations or are applied to Program operations. Examples include:

(1) Cash donations specifically earmarked for use in the Program food service;

(a) Cash that is not earmarked but used in the nonprofit food service is a donation to the nonprofit food service except when repayment is required by terms of a bona fide third party written loan agreement or written interagency fund transfer policy.

(b) Unless a donation is made specifically for the CACFP (i.e., a private donor sends a check for the Program), the money is deposited into the general fund.

(2) Interest earned on advance administrative or meals service funds and facility pass through funds that can be retained by the institution (see item 7, below);

(3) Funds committed by the institution to the Program except for bona fide third party short term loans and interagency transfers to meet cash flow purposes;

(4) Funds received for Program food service activities from any other Federal, State, intermediate or local government source; and

(5) Funds received from the sale of unused or unneeded supplies purchased with Program funds.

c Excluded as Income. The following is never classified as Program or other income:

(1) Internal transfers of funds, to meet cash flow needs, between components of the same institution, i.e., agencies of the same government or divisions of an institution pursuant to the institution's written funds management policies;

(2) Bona fide third party short term loans to meet cash flow needs;

(3) Revenues raised by a public recipient under its governing powers, such as taxes, special assessment, levies and fines unless specifically raised for use in the institution's Program food service; and

(4) Interest earned on CACFP advance funds that must be returned to the grantor agency (see item 7, below).

(IX D 6)

d Use. Program and other income can only be used for allowable Program purposes by:

(1) Deducting the income from CACFP costs in center Programs reimbursed on the basis of the lesser of meals times rates or cost;

(2) Deducting the income from CACFP day care home sponsor administrative costs to determine net reimbursable administrative costs; and

(3) Deducting the income from allowable Program food service account expenses in centers reimbursed using the rate based method when determining if the institution is operating a nonprofit food service account.

7 Interest. Interest can be earned on advance and reimbursement

Interest is income to the Program.

funds. Different requirements apply to the interest earned on reimbursement and advance funds. Different requirements also apply when interest is earned on advance funds by public and nonprofit institutions.

a Reimbursement. For all institutions, interest earned on reimbursement, including facility pass through funds, is other income to the Program and must be recorded and used consistent with items 6(b) and (d) above.

b Advance funds. Both public and not for profit institutions may retain a portion of the interest earned on advance funds; however the retained interest is income to the Program and must be recorded and used consistent with items 6 (b) and (d) above.

(1) Public institutions. Public institutions may retain up to \$100, per Federal fiscal year (7 CFR §3016.21(i)), in interest earned on advance funds; however, the retained interest is income to the Program. Any interest earned in excess of \$100 annually must be remitted to the State agency and the State agency must remit the amount to FNSRO.

(2) Not for profit institutions. Not for profit institutions may retain up to \$250, per Federal fiscal year (7 CFR §3019.22(k)(2)), in interest earned on advance funds; however, the retained interest is income to the Program. Currently, any interest earned in excess of \$250 must be remitted to:

U.S. Department of Health and Human Services (DHHS),
Division of Payment Management
P.O. Box 6021
Rockville, Maryland 20852.

<http://www.dpm.psc.gov/>

(IX D 7 b (2))

For more contact information see:

<http://www.dpm.psc.gov/contacts/contacts.aspx?explorer.event=true>

8 Loans. Loans for Program purposes between the institution and a bona fide third party lending institution may be secured using certain nonprofit food service account assets.

a Permissible. The following can be used as collateral to secure loans:

- (1) Sponsor administrative reimbursement payments;
- (2) Reimbursement payments for affiliated centers; and
- (3) Equipment and other assets that have no current

Federally-funded interest.

b Prohibited. The following cannot be used as collateral to secure loans under any circumstances.

(1) Advances of administrative, food service or center funds. These funds are made available to carry out a specific purpose and may only be used for that purpose. Advance funds remain the property of the Federal Government until used for the specific purpose for which the funds were provided. Therefore, an institution has no authority to put these funds up as collateral;

(2) Reimbursement payments on behalf of day care homes and sponsored facilities not owned by the institution. These payments are not the sponsoring organization's funds but are Federal funds entrusted to the sponsoring organization on behalf of sponsored facilities. As trust funds, the sponsoring organization can only use these funds for the purpose intended;

(3) Equipment or other assets having a residual Federal interest; and

(4) Any nonprofit food service account or nonprofit food service asset when:

(a) The loan, in whole or in part, is for non-Program purposes,

(b) The loan is made to an officer, director or employee, and/or

(IX D 8 b (4))

(c) The lender is not a bona fide third party lending institution.

9 CACFP Close Out Procedures. Institutions are eligible to receive payment for the necessary and reasonable costs of ceasing CACFP participation (See VIII I 38, above). Whether an institution voluntarily (for convenience) or involuntarily (for cause) ceases CACFP participation, the State agency and the institution must make every effort to minimize CACFP close out costs. Close out costs that exceed the regulatory CACFP funding limitations are eligible for reimbursement consistent with the provisions of this Instruction. Individual facility close out costs are not eligible for funding in excess of the institution's maximum regulatory earned reimbursement.

a Notification. The State agency must notify the institution of the availability of reimbursement for close out costs. This notice should be provided promptly after the institution notifies the State agency that it is voluntarily ceasing CACFP participation. When the termination is for cause, this information should be included in the State agency's notice of intent to terminate. The notice must state:

(1) Only necessary and reasonable costs for close out activities that cannot reasonably be avoided are allowable. All other costs incurred after termination are not allowable;

(2) Termination does not affect the right of the State agency and FNS to disallow costs and recover funds on the basis of a later audit or review;

(3) Termination does not affect the institution's obligation to return any funds due as a result of later refunds, corrections or other transactions;

(4) All close out costs require specific prior written approval;

(5) The method the institution must use to request specific prior written approval. For example, the State agency may require the institution to identify each close out cost individually or may permit the institution to identify close out costs by function, with a written explanation of the function. State agencies may require submission of a close out cost budget;

(6) The requirements for timely liquidation of close out costs (see item b(2)(a), below);

(IX D 9 a)

(7) Reimbursement of close out costs will be made after receipt of documentation that the institution has liquidated all CACFP obligations, including all close out costs; and

(8) Close out costs due to the institution will be offset by any outstanding overclaims and unearned advance payments.

b Payment of close out costs. Reimbursement is the preferred method for liquidating the institution's close out costs.

(1) With the specific prior written approval of FNS, advance funds for close out costs can be issued when the State agency determines advance payments are necessary to ensure protection of CACFP funded assets and proper payment of CACFP funds due to unaffiliated sponsored facilities. Advance funding for close out costs is not permitted when the institution has an outstanding overclaim or unearned CACFP advance.

(2) Reimbursement of close out costs will be issued to the institution after the State agency's receipt of documentation that all close out costs and other CACFP obligations have been liquidated.

(a) The institution must liquidate all CACFP and close out cost obligations within 90 calendar days after termination of CACFP participation.

(b) The State agency may establish shorter time frames to permit the State agency to submit the reports required by 7 CFR §3016.50(b) and 7 CFR §3019.71. See: 2 CFR Part 230, Appendix B, 48; and 7 CFR Parts 3016 and 3019, Subparts D for more information on reporting close out costs.

(c) If specifically approved by FNSRO, the State agency may extend the institution's final reporting due date.

(3) Close out costs must be net of all applicable credits, rebates, etc. Close out cost payments are also subject to offsets against overclaims and unearned advance fund payments.

(a) Administrative cost offsets. Payments for administrative close out costs must be offset by outstanding administrative cost overclaims and unearned administrative advance payments.

(b) Operating cost offsets-Independent centers and affiliated sponsored centers. Close out cost payments for operating costs must be

(IX D 9 b (3)(b))

offset by outstanding operating cost overclaims and unearned operating cost advances for independent centers and sponsors of affiliated centers.

(c) Operating costs offsets - Unaffiliated sponsored facilities. Close out cost payments incurred on behalf of unaffiliated sponsored centers and day care homes can only be offset by an outstanding operating cost or day care home meal service payment overclaim or advance payment due to the facility for which the close out costs were incurred.

E Records. Institutions must maintain records that document compliance with Program requirements. In addition to the records already described in this Instruction, the following records must be maintained.

1 Meal Service Records. The following records of meals served to eligible participants and adults are required to support Program earnings:

a Participant Meals. Participant meal counts must be maintained. Attendance data, by itself, cannot be substituted for required meal service records. Back-out, tray count and other exception reporting methods are not acceptable to document participant meal counts.

(1) Centers not using family style meal service. Daily counts of the reimbursable meals served to eligible participants, taken at the point of service, for each meal service.

(2) Centers using family style meal service. Daily counts of reimbursable meals served to eligible participants taken by the conclusion of each meal service.

(3) Homes. Daily records of reimbursable meals served to eligible participants completed, for each meal service, by the end of the day.

b Adult Meals.

(1) Program adults. Institutions that claim reimbursement for the costs of meals served to Program adults must maintain daily meal count records to support all Program adult meals whose cost the institution claimed. These daily meal count records must include the name of the adult, the meal(s) received and the Program duties performed. For individuals (employees and volunteers) who perform Program duties on a continuing basis, employment records or a description of volunteer duties may be substituted for daily records of the Program duties performed.

(2) Non-Program adults. Centers must record the number of meals served to non-Program adults.

(IX E 1)

c Nonparticipant Meals. Records of meals served to nonparticipants must be maintained. Neither the meals nor the cost of meals served to nonparticipants can be claimed for reimbursement. However, nonparticipant meal costs are allowable nonprofit food service expenses when the food service is conducted principally for the benefit of the enrolled participants. Nonparticipants include children in child care centers or day care homes and adults in adult care Programs who receive meals but are ineligible to participate in the CACFP. These participants may be ineligible due to:

- (1) Program age requirements;
- (2) Not enrolled for care;
- (3) Provider's own children that are not income eligible; or
- (4) Exceed the licensed capacity of the day care home or center.

2 Sponsored center and day care home payment reconciliation records. Records of all transactions documenting payment between a sponsoring organization and a sponsored center or day care home must be maintained. These records must be sufficiently descriptive to document by date, the amount of every payment requested or made to each sponsored center or day care home, explain all differences between requested and paid amounts and confirm all funds requested on behalf of each sponsored center or day care home were disbursed to that specific sponsored center or day care home within the five day time requirements. At a minimum, these records must contain:

- a Name of the sponsored center or day care home;
- b Sponsored center or day care home identification number or other unique identifier used by the sponsoring organization;
- c Meal counts and, when applicable, cost data identified with the date the information was received from each sponsored center or day care home;
- d The amount and date of advance funds requested on behalf of the sponsored center or day care home, including the month of the request or subsequent amended request;
- e The amount and date of advance funds received from the State agency on behalf of the sponsored center or day care home with an explanation of

(IX E 2 e)

any differences between the amount requested and the amount received and separate identification of the amount and date by original and amended claims;

f For each reimbursement claim filed on behalf of a sponsored center or day care home, the claim month, amount and date that each sponsored center or day care home's meal counts and, when applicable, cost data, was claimed for reimbursement, with the amount and date for the original and each amended claim identified separately and an explanation of any differences between the amount claimed and the meal count and cost data submitted by the sponsored center or day care home for each original and amended claim;

g The amount and date of each reimbursement payment received from the State agency on behalf of the sponsored center or day care home, with separate identification of the amount and date by original and amended claims, and an explanation of any adjustments between the amount claimed and amount received;

h The amount and date of each payment issued to the sponsored center or day care home, separately identified by type (advance or reimbursement), amount and date for the original and each amended payment;

i The check number or identification number of a negotiable instrument issued under another disbursement method, used to issue each advance and reimbursement payment to the sponsored center or day care home; and

j The date the check or other disbursement method was paid by the bank and the bank statement date verifying disbursement.

(1) Un-liquidated facility advance and reimbursement payments. Banks and other financial institutions establish specific deadlines for honoring checks. Instances arise when checks issued to facilities are not presented timely for payment. Prior to the deadline established by the bank, the sponsoring organization must make a good faith effort, acceptable to the State agency, to determine why the check remains un-cashed. This may include telephone calls, on-site visits or written inquiries. Once the bank's date for honoring the check has passed, the institution must remit the amount of the payment to the State agency with an explanation, and the State agency must remit that amount to FNSRO, or if within the same fiscal year, apply the repaid funds to current CACFP obligations. Should the sponsored facility request a replacement check, the institution must request the funds from the State agency.

3 Financial. Institutions must record the receipt and expenditure of all Program funds, Program income and other income in accordance with U.S. GAAP, this Instruction, Department regulations and the State agency financial management system. Any Program expenses paid for in cash should be of a nominal amount and clearly documented.

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X FOOD DONATION

Distributing agencies are responsible for the distribution of donated foods to participating Child Nutrition Program outlets. This donation activity is authorized by section 17(h) of the National School Lunch Act, as amended, and implemented by 7 CFR Part 226 and Part 250.

A General. Each school year institutions other than sponsors of day care homes are entitled to receive either USDA Foods (donated, entitlement) or payments equal to the value of the USDA Foods (cash-in-lieu of USDA Foods).

Reimbursement rates for sponsors of day care homes established under 7 CFR §226.13 include the value of USDA Foods. Therefore, reimbursement payments for sponsors of day care homes that elect to receive USDA Foods must be reduced by the value of the USDA Foods received.

B Recordkeeping. Institutions that receive donated foods must maintain records documenting the receipt and use of all USDA donated foods. When the costs of receiving USDA donated foods (delivery charges, etc.) are paid by the institution, the institution's records must reflect these costs. The value of the USDA donated foods is not an allowable cost for earning reimbursement or documenting the operation of a nonprofit food service.

Sponsoring organizations of day care homes that receive USDA Foods for distribution to some but not all participating homes must establish procedures and maintain records to ensure that the reimbursement payments to the day care homes receiving the USDA Foods are reduced by the value of the USDA Foods received.

The Distributing agency may establish specific recordkeeping requirements for institutions that receive donated foods.

C Cash-in-Lieu of USDA Foods. The cash-in-lieu-of USDA Food payments received by an institution shall be used only to purchase food products that are produced in the United States for use in the Program. Institutions must maintain sufficient records to document the proper use of these payments.

D Donated Food Processing. When costs of processing entitlement or bonus donated foods into different end products are paid by the institution, these charges can be included as Program food costs. In addition, when the costs of distributing, transporting, storing and handling these end products are not included in the charges for the end products, these costs can be included as Program food costs.

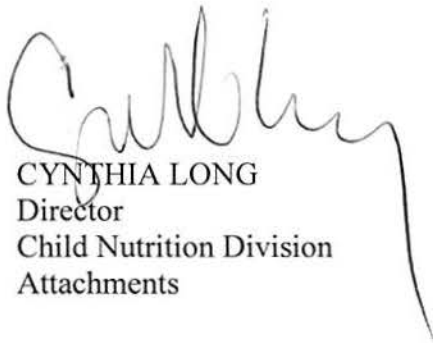
If the value of the donated foods contained in the end products is credited (passed through) to the institution through a refund or rebate system, the value of the refund/rebate must be credited to Program food costs as an applicable credit.

XI IMPLEMENTATION

The provisions of this Instruction shall be implemented in accordance with 7 CFR Part 226.

XII OFFICE OF MANAGEMENT AND BUDGET APPROVAL

The reporting and/or recordkeeping requirements contained herein have been approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1980.



CYNTHIA LONG
Director
Child Nutrition Division
Attachments

GLOSSARY

Terms used in this Instruction are those included in 7 CFR §226.2, 7 CFR Part 3016 and 7 CFR Part 3019.

Accounting Principles Generally Accepted in the United States of America (U.S. GAAP) consists of professional standards that govern accounting for financial transactions. These standards are expressed in statements, interpretations, and other authoritative sources issued by professional standard-setting bodies, such as the Financial Accounting Standards Board; its predecessor, the Accounting Principles Board; the Governmental Accounting Standards Board; and the American Institute of Certified Public Accountants. The term U.S. GAAP has largely displaced the term Generally Accepted Accounting Principles (GAAP) in order to distinguish it from standards promulgated by the International Financial Reporting Standards.

Accrual basis of accounting is an accounting method that measures the financial position of an organization, and the financial results of its operations, by recognizing the effects of economic events when they occur regardless of when cash inflows and outflows take place. That is, revenues are recorded when earned rather than when the resulting cash collections occur; and expenses are recorded when they create liabilities to pay rather than when the bills are actually paid. Comparing (matching) revenues with expenses of the same accounting period (fiscal year) enables an organization to measure its economic performance during that period. This is known as the matching principle of accounting. See also **Cash basis of accounting**.

Acquisition cost is the sum of the net invoice price of a purchased item, plus the cost of modifications, attachments, accessories or auxiliary apparatus necessary to make the item usable for the purpose for which it was acquired. Other charges, such as installation, transportation, taxes, duty or in-transit insurance shall be included or excluded from the unit acquisition cost in accordance with the regular accounting practices of the institution making the purchase.

For buildings and facilities, acquisition cost is the purchase price plus the costs of capital improvements such as paved parking lots, landscaping, sidewalks and fences. It does not include the value of the land; any property tax assessments against the building/facility whether payable or paid, including delinquent tax assessments paid to acquire the property; or any interest charges or costs related to acquiring, maintaining or improving the facility/building, however represented.

Administrative costs are incurred by an institution for planning, organizing and managing a food service under the CACFP and allowed by this Instruction. See also **Operating costs**.

Affiliated center is a child or adult care center that is owned in whole or in part by a CACFP sponsoring organization.

Allocated costs are the portion of shared costs identified as CACFP costs. When a cost benefits two or more cost objectives, the cost must be allocated or distributed among them proportionate with the benefit each received from the cost. Allocation is necessary because it identifies the portion of the cost that has or will benefit the CACFP nonprofit food service. An allowable cost can be charged to the nonprofit food service account as an indirect cost with appropriate documentation.

Applicable credits offset or reduce direct and indirect costs. Examples are purchase discounts, rebates or allowances, recoveries or indemnities on losses, sales of scrap materials, incidental services receipts and adjustments of over-payments or erroneous charges. To be allowable, a cost must be net of all applicable credits. If the credit applies to more than one cost category, the credit must be allocated accordingly. Institutions shall apply and allocate, as necessary, all applicable credits to their Program administrative and operating expenses to reduce Program costs.

Arms-length bargaining means that buyers and sellers act independently from each other when negotiating a price, and they have no relationship to each other that might result in a price that does not reflect the actual fair market value of the good or service. See also **Less-than-arms-length transaction**.

Bonus USDA Foods are USDA donated foods that are not charged against a State agency's or recipient's donated food entitlement.

Capital asset means an item of property whose use will benefit Program operations for more than one accounting period (fiscal year). Capital assets include land, buildings, equipment, etc. See also **Capital expenditure, Equipment, Nonexpendable personal property, and Real property**.

Capital expenditure means an expenditure to acquire a capital asset, materially increase its value, or materially prolong its useful life. Under the accrual method of accounting, the acquisition cost of a building or item of equipment is allocated over that item's useful life; the portion allocated to each accounting period is recorded as depreciation expense. Charging a capital expenditure in its entirety as a direct cost to an institution's nonprofit food service account, or claiming it for Program reimbursement, is known as "expensing" because it treats a capital expenditure like a current operating expense. Expensing requires prior approval. See also **Capital asset, Depreciation, and Direct expensing**.

Cash basis of accounting is an accounting method that measures the financial results of an organization's operations by matching cash collected with cash disbursed during an accounting period (fiscal year). This method equates revenues with cash

collected and expenses with cash paid out. Unlike accrual basis accounting, this method generally does not accurately quantify an organization's economic performance. See also **Accrual basis of accounting**.

Cash-in-Lieu of USDA Foods are cash payments in place of USDA Food assistance provided to States for child and adult care institutions in CACFP, in accordance with Section 17(h)(1)(A) and (B) of the Richard B. Russell National School Lunch Act. These payments are calculated by multiplying the number of eligible, reported lunches and suppers for the claim month by the current USDA Food entitlement rate, established in accordance with Section 6(c) of the Richard B. Russell National School Lunch Act. Cash-in-Lieu of USDA Food payments must be used in accordance with Section X C of this instruction.

Compensatory time is paid leave granted in lieu of a cash payment for overtime or holiday work.

Cost means the dollar value given-up in order to obtain a benefit (property or services). Costs are determined on a cash, accrual, or other basis acceptable to the awarding agency. Cost does not include transfers to a general or similar fund.

Depreciation is the expense associated with the use of capital assets (equipment, vehicles and facilities) owned by the institution. Although recorded as an expense, depreciation does not result in the disbursement of cash or a reduction in the cash balance of an institution. See also **Capital asset** and **Capital expenditure**.

Direct costs are those that can be identified specifically with a particular cost objective, such as a Program or a function or activity within a Program.

Direct expensing means the costs to acquire nonexpendable personal property or make modifications or repairs that materially increase the value or useful life of nonexpendable personal property that are charged as an expense in the accounting period (fiscal year) in which the property is acquired or the repair is made, instead of depreciating the cost over the property's useful life. This accounting treatment is called "expensing" because it departs from U.S. GAAP by treating a capital expenditure like a current operating expense. Direct expensing requires prior approval by the State agency. See also **Capital asset** and **Capital expenditure**.

Durable supplies are items having an expected useful life of more than one year and a unit acquisition cost that is the lower of the definition of equipment set by the Department's grant administrative rules (currently \$5,000 or more per unit) or the institution's definition of equipment.

Equipment is an item of nonexpendable personal property with a useful life of more than 1 year and per unit acquisition cost that conforms to the definition of

equipment set by the Department's grant administrative rules (currently \$5,000 or more per unit). When an institution has a more conservative definition for equipment, the institution must use that definition when applying this Instruction.

Expendable personal property is all tangible personal property other than nonexpendable personal property.

Financial management is directed to the effective control over and accountability for all funds, property and other assets to assure that they are safe-guarded and used efficiently to fulfill authorized purposes. Financial management includes such activities as budgeting, costing standards, internal control, management of revenues and expenses, management of property, procurement standards and fiscal audits. Records of these activities must be supported by source documents that accurately and completely disclose the sources and uses of funds.

Food service management company is an organization, other than a public or private nonprofit school, with which an institution contracts for preparing and, unless otherwise provided, for delivering meals with or without milk for use in the Program.

Holiday pay is earned by an employee for work performed on a recognized holiday that is customarily a non-work day for the institution's employees.

Indirect costs are incurred for a common or joint purpose and are not readily assignable to Programs or other specific cost objectives without exerting effort disproportionate to the results achieved. The nature of indirect costs necessitates assigning them to benefiting cost objectives via methodologies described in OMB guidance at 2 CFR Part 225 and 2 CFR Part 230. Indirect costs assignable to the CACFP can benefit both its operating and administrative functions.

Inventory adjustment is an upward or downward correction to the inventory. The adjustment may be identified during the reconciliation of the recorded (book) inventory with the physical count of the inventory. Adjustments may result from errors that were recorded in a previous inventory or the loss of goods resulting from theft, fire, water, refrigeration breakdown, product contamination, etc. The adjustment must be supported by written records identifying the amount and cause for the adjustment. The records for adjustment should be prepared by the person responsible for safekeeping the inventory. Inventory adjustments should be made to the ending inventory balance and should be approved by a responsible institution official. Upward adjustments in the inventory must be used to reduce the costs charged to the Program.

Less-than-arms-length transaction is one under which one party to the transaction is able to control or substantially influence the actions of the other(s). Such transactions include, but are not limited to, those between divisions of an organization; organizations under common control through common officers, directors or members;

and an organization and a director, trustee, officer, key employee of the institution or such a person's immediate family, either directly or through corporations, trusts or similar arrangements in which a controlling interest is held. All less-than-arms-length transactions by CACFP institutions require specific prior written approval. See also **Arms-length bargaining** and **Related party transaction**.

Lobbying [2 CFR Part 220, (for Educational Institutions) Appendix A, J28]

(1) Attempts to influence the outcomes of any Federal, State, or local election, referendum, initiative, or similar procedure, through in kind or cash contributions, endorsements, publicity, or similar activity;

(2) Establishing, administering, contributing to, or paying the expenses of a political party, campaign, political action committee, or other organization established for the purpose of influencing the outcomes of elections;

(3) Any attempt to influence the introduction of Federal or State legislation; the enactment or modification of any pending Federal or State legislation through communication with any member or employee of the Congress or State legislature, including efforts to influence State or local officials to engage in similar lobbying activity; or any government official or employee in connection with a decision to sign or veto enrolled legislation;

(4) Any attempt to influence the introduction of Federal or State legislation; or the enactment or modification of any pending Federal or State legislation by preparing, distributing, or using publicity or propaganda, or by urging members of the general public, or any segment thereof, to contribute to or participate in any mass demonstration, march, rally, fundraising drive, lobbying campaign or letter writing or telephone campaign; or

(5) Legislative liaison activities, including attendance at legislative sessions or committee hearings, gathering information regarding legislation, and analyzing the effect of legislation, when such activities are carried on in support of or in knowing preparation for an effort to engage in unallowable lobbying.

Nonexpendable personal property is all property with a useful life of more than one (1) year and an acquisition cost that meets the regulatory definition of equipment, currently set at \$5,000 or more per unit. Nonexpendable personal property can be tangible, having physical existence (such as equipment) or intangible, having no physical existence (such as patents, inventions, and copyrights). When an institution has a more conservative definition for nonexpendable personal property, such as a lower dollar threshold, the institution must use that definition when applying this Instruction.

Nonprofit food service includes all food service operations conducted by the institution principally for the benefit of enrolled participants, from which all of the Program reimbursement funds are used solely for the operation or improvement of that food service. Food service account activity must be monitored to determine nonprofit food service status for institutions.

Non-Program adult is an adult who is not a CACFP participant and who does not perform Program labor on the day a meal is served to him or her.

Operating costs are the expenses incurred by an institution in serving meals to participants under the Program and allowed by the State agency financial management system.

Overtime compensation is earned by an employee for work performed in excess of the employee's regular work schedule. The compensation may be paid at a higher rate or may be paid at the employee's regular rate of pay, depending on the institution's policy.

Participant is an eligible child or adult, as defined in 7 CFR §226.2, who participates in the CACFP.

Personal property is property of any kind except real property. Unlike real property, personal property can generally be picked-up and carried away. It may be tangible or intangible. Personal property is classified as either nonexpendable or expendable. See also **Real property**.

Program, as defined in 7 CFR §226.2, means the Child and Adult Care Food Program authorized by section 17 of the National School Lunch Act, as amended.

Program adult is an adult employee or volunteer, but not a CACFP participant, who performs Program labor on the day a meal is served to him or her.

Program costs are allowable costs, both operating and administrative, that are necessary and reasonable for proper and efficient operation of a food service that includes the CACFP.

Prior approval means securing the State agency's permission to incur costs prior to actually incurring them.

Prudent person is a standard used to evaluate a cost's reasonableness by considering whether a sensible person exercising due care would spend the same amount of money on the item or activity in question.

Real property is land, including land improvements and structures, excluding movable machinery and equipment.

Reimbursement means Federal financial assistance paid or payable to institutions for Program costs within the rates assigned by the State agency. Reimbursements are payments made for eligible meals served that are based on the number of meals served by meal type, current Federal meal reimbursement rates, and the eligibility categories (free, reduced price, non-needy) of enrolled children. This does not include Cash-in-Lieu of USDA Foods payments.

Related party transaction is a transaction between the institution and its parent corporation, corporate divisions, subsidiaries, an employee(s), officer(s), agent(s) of the institution or members of their immediate family either directly or indirectly through corporations, trusts or similar arrangements in which they hold a controlling interest, no matter how represented. All related party transactions are less-than-arms-length transactions. See also **Arm's-length bargaining** and **Less-than-arms-length transaction**.

Shared costs are direct costs that benefit more than one cost objective and can be readily allocated to the objectives benefited. Shared costs are also referred to as "joint costs."

Specific prior written approval means securing the State agency's or, in some cases, FNS's permission in advance of incurring costs. Except in cases of emergencies, this permission must be in writing.

Suppliers are public organizations, private commercial enterprises or individuals with whom the institution contracts for goods and services. Suppliers are also referred to as vendors.

Supplies are items of personal property other than equipment. Supplies are also referred to as "expendable personal property" because they are generally consumed in use.

Termination is the permanent withdrawal of authority to participate in the CACFP. Termination includes voluntary withdrawal.

Unaffiliated center is a participating sponsored child or adult care center that is legally distinct from its sponsoring organization.

Unfunded cost is the difference between the amount of cost incurred and the funds available to pay the cost.

Use allowance can be used as an alternative to computing depreciation expense in Federal Programs. The maximum annual use allowance for buildings and improvements is 2 percent. For equipment, it is $6 \frac{2}{3}$ percent.

FOOD COST

All institutions are required to adhere to the Federal procurement requirements when procuring foods, supplies, equipment, and other goods and services for the CACFP.

For further information, review USDA's web-based procurement training available online through The University of Mississippi's National Food Service Management Institute (NFSMI) at the following web address: <http://www.nfsmi.org>. This training provides interested parties a better understanding of how to best perform responsibilities in the area of procurements and provides information on the Federal procurement requirements. The web-based training is comprised of three topic areas which build upon each other and move from more general procurement issues to more specific ones. State Agencies, institutions, and interested parties can register for the web-based Procurement training at NFSMI's website, found at the following link: <http://www.nfsmi.org/Registration.aspx>.

Additionally, all institutions and facilities, other than day care homes and sponsoring organizations of day care homes, must compute the cost of food used in the Program.

A Cost of Food. The cost of food is the net cost of food purchases and the net cost of delivered meals and foods.

1 Net Food Costs. The cost of food and meal purchases must be net of all applicable reductions and unallowable costs. All reductions must be documented and subtracted when computing net food costs.

a Cost reductions include returns to suppliers, credits, allowances on invoices for unacceptable food, cash discounts and rebates.

b Unallowable costs include:

(1) Foods purchased for catering and vending operations;

(2) The cost of foods or meals purchased only for adults not participating in the Program;

(3) The cost of foods or meals not meeting specifications;

(4) The cost of foods or meals not properly procured;

(5) The cost of meals missing a component;

(6) Spoiled meals or foods; and,

(7) The value of donated foods. (See item B, below for more information.)

B Allowable Food Costs. Allowable food costs are the net price of the purchased and vended foods and meals used in the Program. Costs associated with growing food to be used in the meal service are allowable. These costs include seeds, fertilizer, labor, plot rental, etc. Costs associated with nutrition activities that include growing food which will be used in the meal service are allowable. Costs associated with the receipt, storage and use of USDA donated foods are allowable, but the value of donated foods is not. FSMCs must credit institutions for the value of donated food received in the school year or fiscal year, whether the donated foods are used in that year or not (7 CFR §250.51(a)). Processors must credit the institution for the donated food value in end products in accordance with the requirements in Subpart C of Part 250.

1 Food Purchases. Since allowable food cost is determined by the net cost of food used and not the cost of all food purchased, food purchases must be reconciled to the cost of the food actually used. The Purchase Method or the Inventory Method or both is used to determine the costs of purchased food used. The reconciliation of food purchased to food used must be conducted at least annually, but State agencies can require more frequent reconciliation, i.e., monthly, quarterly or semi-annually.

a Purchase Method. This method is appropriate for perishables, such as fresh produce and dairy products, or when food inventories are not maintained because food is purchased and used almost immediately. The cost of food used is calculated by summing the net price for each item purchased during the period.

The following information for each item purchased is needed to compute the net price of the food used. Exhibit E provides a suggested format that can also be used.

- (1) The name of the item;
- (2) The date of the purchase;
- (3) A description of the purchase unit (cans, half-pints, pounds, cases, etc.);
- (4) The number of units purchased;
- (5) The gross price per unit;
- (6) Any price reductions; and
- (7) The net price (5 above less 6).

b Inventory Method. The inventory method computes the difference between the beginning inventory, the value of foods added to inventory during the period and the ending inventory. When inventories are maintained, a physical count of food in the inventory must be conducted to accurately compute the cost of food used. (See item (2) below for more information.)

(1) Assigning inventory values. In calculating the value of an inventory, the first-in, first-out method should be used. Under this method, the oldest item of a product in the inventory and its cost is considered to be the first item of that product that is withdrawn from the inventory. While first-in, first-out reflects good inventory management practices, it does not mean that the oldest item is actually used first, but it does represent a method for assigning a cash value to the items in inventory. Any other method of valuing the inventory requires specific prior written approval.

(2) Physical inventory. The physical inventory is required for the Federal fiscal year end closeout of each institution's Program activities and must be conducted at least annually. State agencies may establish more frequent physical inventory requirements. Exhibit G, attached, has a sample format that can be used for reconciling the results of the physical inventory, while Exhibit H, also attached, may be used for recording inventories.

(a) Inventory adjustments. Adjustments must be made to the inventory for changes resulting from miscounts, fire, water damage, spoilage, etc. Records of major (more than \$100 annually) inventory adjustments showing the same information as the inventory records must be maintained. Recording minor increases and reductions as an inventory adjustment is not required.

(b) Insured inventory losses. Records of insurance claims and collections for insured inventory losses must be maintained. An inventory adjustment is not required for the amount of a nominal insurance deductible applied to an inventory loss. The deductible is separate and distinct from minor reductions in inventory.

(c) Uninsured and other inventory losses. All other losses are unallowable costs, including the costs of losses that could have been covered by insurance.

(3) Formula. The following formula can be used when a food inventory is maintained.

1	Value of beginning inventory [Date]		\$		
2a +	Total cost of food purchased	\$			
2b -	Reductions (credits, returns and rebates)	\$			
2c =	Net cost of food purchased (2a minus 2b)		\$		
3	Cost of beginning inventory (i.e., food available; 1 plus 2c)			\$	
4 -	Cost of ending inventory [Date]			\$	
5 =	Cost of food used (3 minus 4)				\$
6a	Upward inventory adjustments	\$			
6b	Downward inventory adjustments	\$			
6c =	Inventory adjustments (6c equals 6a + 6b)		\$		
7 =	Net cost of food used (5 plus 6c*) [Date]	* [or 5 minus 6c if 6c is negative]			\$

2 Allowable Vended Meals/Food Costs.

a Unitized Meals.

(1) When unitized meals are vended, the allowable costs are the number of meals meeting Program requirements that were actually served.

i. When excess meals are held over for service on the following day, the cost of the meals can only be claimed once, either on the day of receipt or the day of service.

ii. §226.20(j) states “in recognition of the fluctuation in participation levels which makes it difficult to estimate precisely the number of meals needed and to reduce the resultant waste, any excess meals that are ordered may be served to participants and may be claimed for reimbursement, unless the State agency determines that the institution has failed to plan and prepare or order meals with the objective of providing only one meal per participant at each meal service.”

(bulk) food is:

- b Vended Food Deliveries. The allowable cost for vended

- (1) The amount of eligible food used in the Program meals that was actually served.

Note: When excess foods are held over for service on the following day, the cost of the foods delivered can only be claimed once, either on the day of receipt or the day of service.

C Nonprofit Food Service Costs. In all States, the net costs of purchased foods used or meals served to participants are allowable nonprofit food service account costs. However, total allowable food costs must be adjusted in States that use cost based reimbursement to determine reimbursable food costs.

1 Cost Based Reimbursement. For purposes of claiming reimbursement in States that use cost based reimbursement, Program food costs for self-prep Programs are the net costs of the food purchases that were actually used in meals served to eligible participants and Program adults. For vended Programs, Program food costs are the costs of meals actually served to eligible participants and Program adults.

D Required Documentation. Records of the cost and quantity of food purchased, cost reductions, and amount of food used must be maintained.

- 1 Food Purchased. Required food cost records include:
 - a Procurement documents, including bids and contracts;
 - b Purchase orders;
 - c Delivery receipts;
 - d Invoices;
 - e Canceled checks;
 - f Itemized cash receipts;
 - g Purchase records;
 - h Cost records for transporting, storing, handling and processing that are not included in the purchase price;
 - i Credits, returns and rebates; and

j Inventory records.

2 Purchased Meals and Food Obtained from Schools, Institutions or FSMCs. Required records include:

a Procurement documents, including bids, requests for proposals and contracts;

b Order forms;

c Delivery notices signed by a designee of the institution verifying:

(1) The itemized number of meals of each type delivered;

(2) For bulk deliveries, the type and amounts of food included in each delivery; and

(3) The number or amount of any missing, spoiled, or rejected meals or foods.

d Records of returns, allowances, cash discounts taken, refunds, rebates and other credits when the credit is not shown on the invoice or delivery notice; and

e Canceled checks or other payment receipts.

3 Other Records.

a Menu records that identify the meal components served to participants must be maintained. Menu records must be updated to reflect changes to planned menus so that the menu records reflect the actual meal components and foods service to participants.

b Any other food service records required by the State agency must be maintained (7 CFR 226.15(e)(10)).

E USDA Donated Foods. Allowable costs include transporting, storing, handling and processing USDA donated foods.

1 Centers. For centers, these costs are allowable Program food costs.

2 Sponsoring organizations of day care homes.

a With specific prior written approval, the sponsoring organization may:

(1) Claim as administrative costs, the reasonable and necessary costs for distributing and processing USDA Foods when these costs are not charged to the day care home provider (7 CFR §226.16(g)); or

(2) With the written consent of the day care provider, (7 CFR §226.18(b)(7)), incur the costs of distributing and processing USDA Foods and deduct these costs from the Program payments to the day care home provider.

b Although prior State agency approval is not required, sponsoring organizations that absorb all donated food distribution and processing costs without charge to either the day care home provider or administrative costs should inform the State agency of this decision.

INDEX

The following index is a quick reference tool for information contained in this Instruction. Readers should refer to the Instruction for additional information. Unless noted, items are found in Section VIII, I. **NOTE:** The following captions do not convey approval of any cost or component of cost.

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Instructions

This format can be used for property management purposes and for computing and recording depreciation.

A. Record the date the item was purchased. If the item was placed into actual use after the date of purchase, identify the purchase date and the date the item was placed into service which is the effective date for depreciation.

B. Self-explanatory.

C. Include the purchase price, delivery, set up charges, and any in-transit insurance. DO NOT INCLUDE any financing or interest charges. Identify, record, and deduct the amount and source of any Federal funds used to pay for all or any portion of the item's cost or to meet a matching of a Federal grant from the acquisition cost. Deduct any refunds, rebates, and prompt payment discounts received. If the item was received as a result of a trade or a trade-in was used, deduct the amount received for the traded item from the adjusted acquisition cost of the new item, then add back the lesser of: (1) the non-Federal share of the fair market value, (2) un-depreciated non-Federal share of the original item or (3) non-Federal share of the trade-in.

For donated equipment or when the acquisition cost is not known, use the current fair market value of the item at the time of donation. Only the costs incurred in obtaining and placing donated equipment into service may be depreciated.

D. Identify the depreciation method that will be used. Here are two common examples:

The *straight-line method* (SL) assumes that an object declines in value by an equal amount every year. To calculate it, subtract the salvage value of a piece of equipment, then divide the remaining value by the years of useful life. For example, imagine a \$5,500 vehicle:

It has a \$500 salvage value and a useful life of 10 years;

Subtracting the \$500 salvage value gets \$5,000 ($\$5,500 - \$500 = \$5,000$);

Dividing \$5,000 by 10 gets \$500 ($\$5,000/10 = \500); and

The company therefore subtracts \$500 from its income each year as a depreciation expense.

The *double-declining balance (DDB) method* functions the same way as declining balance depreciation, but at an even more accelerated rate of 2 times the straight-line depreciation rate. For example, a \$1,000 asset with a lifespan of 10 years, and a straight-line depreciation rate of \$100 per year, would have a double-declining balance depreciation of \$200 the first year, \$160 the second year, \$128 the third year, and so on.

E. For the annual amount using the SL method, divide column C by column D, Life Expectancy. For a monthly depreciation amount, divide the annual amount by 12. Record the depreciation amount and indicate whether the amount is yearly or monthly. For methods other than SL, make the necessary calculations, enter the amount, and indicate whether the amount is monthly or yearly in column E. Depreciation must be recomputed each year for all depreciation methods other than SL or whenever capital improvements to equipment are made, regardless of the depreciation method used.

F. Record the current location of the item, its condition, current use, and the date this information was recorded. Record how and when (date) the item was taken out of service, sold, disposed of, or traded. Update this information annually.

NOTE: A biennial physical inventory is also required for items funded with Federal funds or used to meet a Federal matching requirement. Maintain the results of the physical inventory with this format. Depreciation and physical inventory records must be retained permanently.

SUGGESTED FORMAT FOR THE COST OF GOODS USED

For the Period Beginning _____ Ending _____

Circle One:

Food
Nonfood Supplies
Office Supplies

A. Beginning Inventory Value		\$ _____
B. Total Purchases During the Period	+	_____
C. Adjustments	-	_____
D. Total Available	=	_____
E. Ending Inventory	-	_____
F. Cost of Goods Used	=	\$ _____

Instructions

Use the information from Exhibits F and H to complete this format. When a physical inventory was conducted, also use the information from Exhibit G.

- A. Record the Beginning Inventory Value from Exhibit H.
- B. Record the Total Net Purchases from Exhibit F.
- C. Add or subject inventory adjustments from Exhibit G
- D. Add lines A and B and record the results.
- E. Record the Ending Inventory from Exhibit H or the adjusted ending inventory.
- F. Subtract line D from line C and record the results.

SUGGESTED FORMAT FOR A PURCHASE RECORD

Circle One:

- Food
- Food Service Supplies
- Office Supplies
- Other (Describe): _____

A	B	C	D	E	F	G
Date	Item	Purchase Unit	Quantity Purchased (in Units)	Unit Cost	Discounts/ Refunds	Total Cost

H. **Total Net Purchases** \$

Instructions

Use this format to record purchase information.

Use a separate format for each major category of purchases during the accounting period. Circle the appropriate category (e.g., food, office supplies, etc.).

Use invoices, sales receipts, etc., to determine the entries for columns A, B, C, D, E, and F.

- A. Record the date of purchase.
- B. Describe the item.
- C. Record the purchase unit in whole numbers only. When less than whole cases are purchased, record the individual unit. For example, the purchase unit for 1½ cases of peas would be cans.
- D. Record the total number of units purchased, i.e., 1½ cases of peas (24 cans to a case) would be recorded as 36 cans.
- E. Record the gross price per unit before any refund, rebate, or discount is taken.
- F. Record the total (not unit) refund, rebate, or discount.
- G. Multiply column D by column E, then subtract column F. Record the results.
- H. Add column G to determine the total net value of purchases during the period.

When a significant supply of a nonperishable purchased item is still available for use at the end of the accounting period, the cost of purchases should be reduced by the value of this remaining balance and the balance should be transferred to the inventory record (Exhibit H).

SUGGESTED FORMAT FOR INVENTORY RECONCILIATION

Circle One:

- Food
- Food Service Supplies
- Office Supplies
- Other (Describe): _____

For the Period Ending: _____

A	B	C	D	E	F	G
Item	Physical Inventory Balance	Recorded Ending Balance	Difference (B—C)	Unit Price	\$ Net Difference	Explanation

H. Total Inventory Adjustment \$ _____

Instructions

Use this format to reconcile inventory differences between the physical inventory and the book inventory.

Use a separate format for each major category in the inventory. Circle the appropriate category (e.g., food, office supplies, etc.) and enter the last day of the inventory period that is to be reconciled. After the reconciliation is completed, the book inventory must be adjusted to reflect the results of this reconciliation.

- A. Record the item name.
- B. Record the balance determined by the physical inventory for the item.
- C. Enter the amount (Balance) from Exhibit G, column B.
- D. Subtract column C from column B. Identify whether the difference is a shortage (-) or a surplus (+).
- E. Enter the amount (Unit Price) from Exhibit G, column C.
- F. Multiply column D by column E and record the results. Record the same sign (+ or -) used in column D.
- G. Self-explanatory.
- H. Add column F to determine the amount of the net inventory adjustment.

Instructions

Use a separate format for each major inventory category or specific inventory item.

Record the name of the inventory category (i.e., food, nonfood supplies, office supplies, or specific item) on the line provided.

Record the beginning inventory value.

- A. Record the date of each receipt and withdrawal to the inventory.
- B. Record the quantities received or withdrawn from the inventory using whole numbers. For example, 1½ cases of canned peas should be recorded as 36 cans. For withdrawals, the first-in/first-out method should be used. This means that the items added to the inventory first should be recorded as used first.
- C. Use invoices, sales receipts, or column E of Exhibit F and record the unit price.
- D. At the end of the accounting period, multiply any amount under column B (Balance) by column C and enter the results.
- E. Total all entries in column D to determine the ending inventory value. This amount will become the beginning inventory value for the next accounting period.

Exhibit I

Costs Requiring Additional Approvals:

Items Requiring Prior Approval, Specific Prior Written Approval, and FNSRO Approval
 (All Sections refer to VIII, I)

<i>Topic or Cost</i>	<i>Section</i>	<i>Page #</i>	<i>Description</i>	<i>Prior Approval</i>	<i>Specific Prior Written SA Approval</i>	<i>Specific Prior Written FNSRO Approval</i>
Advertising & Public Relations Costs	3 a (2)	19	Public relation costs for pamphlets, news releases and other information services	YES		
Communications	8 a (1)	21	Cellular phones and pagers owned or leased by the institution – SAs must impose specific prior written approval		YES	
Contributions & Donation Costs	10 a	22	Costs required to make goods or services donated to the institution usable for the Program		YES	
DCH Licensing Standards Costs	12 a (1,2 & 3)	26	Supplies such as smoke detectors & fire extinguishers; minor alterations such as adding handrails; and the costs of fire & safety inspections & licensing fees that are required to permit an income eligible day care home to meet licensing approval standards		YES	
Depreciation and Use Allowance	13 b	28	All space and facility depreciation methods other than 30-year straight line or method used and accepted for Federal income tax reporting purposes		YES	

<i>Topic or Cost</i>	<i>Section</i>	Page #	Description	Prior Approval	Specific Prior Written Approval	Specific Prior Written FNSRO Approval
	13 a (1)	28	For publicly owned buildings, the amount assigned as the acquisition cost		YES	
	13 d(1)(a)	29	All equipment depreciation methods other than 15-year straight line depreciation or method used and accepted for Federal income tax reporting purposes		YES	
	13 d (1)(c)	30	Unknown acquisition cost		YES	
Employee Morale, Health, & Welfare Costs & Credits	14	32	All costs in this category		YES	
Expensing Equipment and Other Property	16 a	34	The Program's share of the cost for most equipment and improvements can be directly expensed (NOTE: See item 16 b for unallowable costs.)		YES	
Facilities & Space Costs	17 a (3)	38	The costs for rearrangement & alterations to facilities owned by the institution that are necessary for efficient and effective Program operations but do not result in capital improvements (NOTE: See 17 b for unallowable costs.)		YES	
Insurance	21 a (2)(a)	37	Costs of other insurance, not required by the SA, that is maintained by the institution in connection with the general activities of the Program when the type, extent, and cost of coverage are in accordance with general State or local government policy and sound business practices		YES	

<i>Topic or Cost</i>	<i>Section</i>	Page #	Description	Prior Approval	Specific Prior Written Approval	Specific Prior Written FNSRO Approval
	21 a (2) (b)	37	Costs of insurance or contributions to any self insurance reserve covering the risk, loss, or damage to Federal Government property to the extent that the institution is liable for such loss or damage		YES	
	21 a (2) (c)	37	Cost of directors and officers insurance provided that the insurance policy actually provides liability coverage related to the CACFP and, if the policy also provides coverage for non-CACFP liability, the CACFP share of the cost is properly allocated		YES	
	21 a (2) (d)	37	Contributions to a reserve for self insurance to the extent that the reserve meets State insurance requirements and the type of coverage, extent of coverage, and the rates and premiums would have been allowed had insurance been purchased to cover the risks		YES	
Interest, Fundraising, & Other Financial Costs	22 a (1) (a) i	38	Stop payment charges for facility advance and reimbursement payments and other Program disbursements, whether by check or EFT		YES	
	22 a (1) (a) ii	38	Program account reconciliation and analysis fees, including the allocated share of fees charged for commingled accounts		YES	

<i>Topic or Cost</i>	<i>Section</i>	Page #	Description	Prior Approval	Specific Prior Written Approval	Specific Prior Written FNSRO Approval
	22 a (2)	38	Interest incurred after 10/1/98, for nonprofit private institutions and after 10/1/80, for public institutions on institutional debt used to acquire or replace allowable equipment or other property or make allowable improvements (NOTE: See unallowable costs.)		YES	
	22 c (1)	40	Arms-length transactions involving loans or financial transactions (NOTE: See section on information required when requesting specific prior written approval.)		YES	
	22 c (2)	40	Less-than-arms-length transactions involving loans or financial transactions (NOTE: See section on information needed when requesting specific prior written approval.)		YES	YES
Labor Costs	23 d (1)	48	Compensation to members of nonprofit institutions, trustees, directors, associates, officers or the immediate families thereof		YES	
	23 d (2)	48	Stipends to compensate board members for the costs of attending corporate meetings when Program business is conducted		YES	

<i>Topic or Cost</i>	<i>Section</i>	Page #	Description	Prior Approval	Specific Prior Written Approval	Specific Prior Written FNSRO Approval
	23 d (3)	48	Any change to an institution's compensation policy that results in a substantial increase in the institution's level of compensation to an individual or all employees		YES	
	VID 3	7	Excess funds from an institution's nonprofit food service account used for increases in salaries or fringe benefit costs to improve food service operations, principally for the benefit of the participants.		YES	
Overtime, Holiday Pay, and Compensatory Leave	23 h	50	Payment of overtime, holiday pay for work performed on a non-work holiday and compensatory leave (NOTE: See section regarding exceptions.)		YES	
	23 i	51	Incentive payments and awards (except for awards of minimal value, see item 23 i(6)).		YES	
Severance Pay	23 j	52	Severance pay when it does not constitute excess compensation and is required by law, written employer/employee agreement, written policies of the institution, or the terms of a negotiated written labor relations agreement		YES	
	23 k (11)	55	Amendments or modification to approved deferral plans		YES	
Legal Expenses & Other Professional Services	24 a (1)	56	The sponsoring organization's cost to pursue administrative and judicial recovery of funds due from sponsored facilities		YES	

<i>Topic or Cost</i>	<i>Section</i>	<i>Page #</i>	<i>Description</i>	<i>Prior Approval</i>	<i>Specific Prior Written Approval</i>	<i>Specific Prior Written FNSRO Approval</i>
	24 a (2)	56	The institution's costs for services performed by individuals who are not officers, employees or members of the institution (NOTE: See section for additional information.)		YES	
Management Studies	26 a	58	The cost of studies directly related to the Program that are performed by entities other than the institution itself		YES	
Materials & Supplies	27	58	SAs may establish specific prior written approval requirements for durable supply acquisitions		SA decision	
Meetings & Conferences	28 a (1)	59	Travel & registration fees for attending meetings and conferences devoted solely to the CACFP	YES		
	28 a (2)	59	allocated share of travel & registration fees when CACFP is only a portion of a larger child and adult care-related agenda		YES	
Membership, Subscriptions, & Professional Organization Activities	29 a (4)	60	Costs of public and not for profit institution memberships in civic or community organizations			YES
Participant Training & Other Participant Support Costs	30 a (1)	61	Training-administrative costs (NOTE: See section for a list of these costs.)	YES		

<i>Topic or Cost</i>	<i>Section</i>	<i>Page #</i>	<i>Description</i>	<i>Prior Approval</i>	<i>Specific Prior Written Approval</i>	<i>Specific Prior Written FNSRO Approval</i>
	30 a (2)	62	Training-operating costs (NOTE: See section for a list of these costs.)	YES		
	30 a (3)	62	Facility appeal costs (NOTE: See section for more information.)	YES		
Proposal Costs	32	64	Costs of preparing proposals on potential FNS Child Nutrition Programs grants		YES	
Publication, Printing, & Reproduction	33	64	All allowable costs	YES		
Purchased Services – Other	34 a (1) (a)	65	Arms-length transactions for the maintenance, repair or upkeep of administrative and food service equipment that neither adds to its permanent value nor prolongs its intended life	YES		
	34 a (1) (b)	65	Costs of utilities, purchased security and janitorial service, etc., not included in space or labor compensation costs	YES		
	34 a (2)	65	All less-than-arms-length transactions; maintenance and service repair contracts on Program equipment; and all other purchased service costs needed for Program operation		YES	
Rental Costs	36 d	68	Special lease arrangements – capital leases, sale-with-lease-back leases, less-than-arms-length transactions involving space/building rental, and lease with option-to-purchase (NOTE: see section for more information.) These also require special consideration.		YES	

Questions and Answers

Allowable Costs

Q. A sponsoring organization of centers has submitted its budget for approval; however, there are several questionable costs included in the budget. These are:

- 1. The monitors are listed as contractors – \$25 per visit, \$0.55 per mile;**
- 2. Leased office space – building owned by the Chairman of the Board;**
- 3. Coffee mugs with agency logo – listed under training supplies;**
- 4. Target gift cards for employees – listed under miscellaneous expense; and**
- 5. 45 lunches @ \$10.00 each – listed as a training cost.**

Are these allowable expenses?

A. 1) Purchased services require specific prior written approval and the State agency should carefully evaluate all of these contracts. 2) The office space is allowable with specific prior written approval; nevertheless, the sponsor needed to disclose the less-than-arms-length transaction and the amount needs to be properly allocated. Also, the proper amount needs to be based on the amount that would be allowable if the sponsor owned the property; i.e., depreciation cost (acquisition cost, less the value of the land, divided by 30 years), or use allowance, plus maintenance, taxes, and insurance. 3) Coffee mugs are not allowable as a participant training cost because gifts are not allowable. 4) On the other hand, the gift cards are allowable as an employee appreciation award and the State agency has the right to establish a maximum cost for awards of minimal value. 5) Provided the costs are reasonable and necessary, the cost for meals and nonalcoholic beverages served to participants, but not to guests, is allowable when Program training is presented concurrent with the meal service.

Q. A sponsoring organization of day care homes submits its budget for approval. There are several questionable expenses included in the budget such as:

- 1. Health club membership reimbursement – 25 employees x 12 months x \$25 per month = \$7,500;**
- 2. All employees receive a 3 percent lump sum payment of annual wages in December based on the past 12 month earnings;**
- 3. Annual provider training – recordkeeping software (financial and CACFP) – 1,000 x \$25 = \$25,000;**
- 4. Tote bags – 1,000 x \$10 = \$10,000; and,**
- 5. Supplies – Coffee, coffee filters.**

Are these allowable costs?

A. 1) With specific prior written approval, the health club membership reimbursement is an allowable employee morale cost. 2) The 3 percent lump sum payment is an allowable labor cost because it is not considered an incentive, but rather part of the employee regular compensation. 3) The cost of software is only 50 percent allowable, or \$12.50 per item; i.e., this expenditure must be allocated because it is both a Program and non-Program cost. 4) The tote bags are not an allowable participant

support cost or outreach cost. 5) The cost for coffee and coffee filters are not considered a Program expense.

Benefits.

Q. In cases where there are no participating insurance programs, how are costs for gym memberships and exercise Programs treated?

A. It is clear from policy and regulation that the statutory intent of the administrative reimbursement provided to sponsoring organizations is to be used for oversight of the operation of the Program. It is true that such costs can be claimed under VIII I 14 a(2) of this Instruction in the case that such benefits existed before the sponsoring organization began participation. However, this cost requires specific prior written approval to be allowable. The State agency is encouraged to ensure that the sponsoring organization is obligating sufficient money to fully meet all of its other administrative duties before approving such costs. If the State agency decides not to allow these costs, the sponsoring organization will have the right to appeal the decision.

Depreciation.

Q. Can any tangible item be depreciated?

A. No. To be depreciable, the item must meet the following requirements,

- The institution must already own the item (not purchased with Federal funds);
- The item must be used in the institution's Program operations;
- The item must have a determinable useful life; and
- The item's expected useful life must be more than one year.

Q. How does straight line depreciation work?

A. It depends on the item and the useful life of the item. For example, an institution purchases a car to be used for monitoring facilities. It will not be used for any other purpose.

The purchase price is \$15,000. The institution uses non-Program funds to pay for the vehicle. The useful life of the car is 5 years. Divide the number 1 by the useful life of the property to get a straight line rate. $1 \div 5 = 1/5$ or 20 percent. Multiply the purchase price times the straight line rate to establish how much depreciation per year may be charged to the nonprofit food service account.

$$\$15,000 \times .20 = \$3,000 \text{ per year}$$

In this case the institution may only charge actual costs of operating the vehicle or mileage costs, but not both. For more information see Travel, VIII I 39 a(2).

Another scenario for a vehicle would be if the institution used it for multiple purposes. In this case, the institution would need to allocate the depreciation figure by percent of miles used.

Instead of charging the whole \$3,000 to the nonprofit food service, the institution would need to establish the percent of Program miles to the total miles and multiply the \$3,000 by that figure.

12,000 total agency miles; 8,000 Program miles

$$8,000 \div 12,000 = 2/3 \text{ or } 67 \text{ percent}$$

$\$3,000 \times .67 = \$2,010$ per year may be charged to the nonprofit food service account.

Q. How can the institution establish a “use allowance” for items that have been fully depreciated?

A. Vehicles – The continued use of a fully-depreciated vehicle will provide benefits to the Program. The institution will incur costs when the vehicle is used for Program business such as facility monitoring or attending Program related meetings and trainings. The institution may claim the actual costs for operating the vehicle such as gas, oil, routine maintenance, insurance, depreciation, use allowance or leasing fee or the institution can claim a mileage allowance.

When claiming a “use allowance” as part of the actual costs, the institution is limited to annually claiming 6 2/3 percent of the acquisition cost. However, the State agency may negotiate with the institution a more reasonable “use allowance” after considering the amount of depreciation already 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 use of the item.

For example:

The vehicle acquisition cost \$10,000

Maximum allowable annual use allowance is 6 2/3 percent of the acquisition cost

$$\$10,000 \times .0667 = \$667$$

The institution can include the \$667 as part of the actual costs of operating the vehicle.

$$\text{Gas } \$500 + \text{Oil } \$40 + \text{Maintenance } \$1,000 + \text{Insurance } \$1,000 + \\ \text{Use allowance } \$667 = \$3,207$$

Or

Program Mileage

A vehicle used to monitor facilities

$$10 \text{ facility visits a week} \times 25 \text{ miles per visit} \times 52 \text{ weeks} \times \$0.55 \text{ per mile} = \$7,150$$

A vehicle used to attend Program meetings and training

$$25 \text{ miles per week} \times 52 \text{ weeks} \times \$0.55 \text{ per mile} = \$715$$

B. Building – If an institution owns the building, once the value of the property has been fully depreciated, the State agency may approve as an allowable expense rent that includes an amount for using the space in the building. The use allowance cannot exceed 2 percent of the building's original acquisition cost less the value of the land.

For example:

Acquisition Building price \$125,000 - \$38,000 value of the land $\times .02 = \$1,740$ per year.

Facilities and Space Costs.

Q. What is the difference between a necessary alteration made to and a capital improvement of space and facilities under VIII I 17 a(3)?

A. The largest difference between an alteration and a capital improvement is that a capital improvement either permanently increases the value of a property or significantly increases its useful life. Necessary alterations, on the other hand, increase the efficiency and efficacy of Program delivery without increasing value or extending the useful life.

Examples of necessary alterations include rearranging an office, installation of temporary walls or cubicles to efficiently divide space, routine maintenance for kitchen or household items, repairing a fence, etc.

Examples of capital improvements include kitchen remodeling or renovation, adding additional rooms, replacing a roof, installing central air conditioning, etc.

“Generally allowable costs.”

Q. The last sentence in the description of generally allowable costs is confusing (“Approval of the budget results in the approval of the budget line items but is not a guarantee of the allowability of any particular cost or funding of the budget line item”) (Section VIII Standards for Allowable Costs, D). Does the State agency’s approval of a line item in a budget mean that all costs included in the line item total are allowable?

A. A line item that received approval does not necessarily mean that all costs included in the line item total are allowable. For example, training is a generally allowable cost item. An institution enters \$3,500 in the training line item but does not list what cost items are included in the \$3,500. The State agency learns during a review that the \$3,500 included tote bags and coffee mugs with the Agency logo for each participant. Tote bags and coffee mugs with the Agency logo are not allowable expenses.

Another example of a generally allowable cost item is food costs. Food costs are allowable, but the State agency learns the institution is serving a fruit drink instead of 100 percent fruit juice. Fruit drinks are not a creditable food item and would not be an allowable food cost.

Income to the Program

Q. Can a State agency require a sponsoring organization to have separate bank accounts for facility meal reimbursements, administrative reimbursements, and income to the Program?

A. FNS Instruction 796-2 discusses facility funds integrity at IX B 3(b). Sponsoring organizations may use a separate bank account for facility payments or a commingled account. Sponsoring organizations using a commingled account must maintain funds in the account that equal all un-cashed facility payments and any other checks or automatic payments that have not cleared the bank.

Neither Regulation 7 CFR Part 226 nor Instruction 796-2 inhibits the State agency from requiring sponsoring organization to have separate bank accounts.

For example, when conducting an evaluation of the sponsoring organization’s nonprofit food service, the State agency learns the sponsoring organization does not have adequate funds in their commingled account to cover all the un-cashed facility meal reimbursement

payments. As a corrective action, the State agency may require the sponsoring organization to maintain separate bank accounts for facility meal reimbursements and administrative reimbursements.

However, if a State agency required this of all sponsoring organizations this would be considered an additional State agency requirement and must be approved by the appropriate FNSRO before being implemented (7 CFR 226.25(b)).

Q. Are food donations or in-kind contributions considered income to the Program?

A. Donations of items other than money are not considered income under the definition provided in item IX D 6 of this Instruction. However, sponsoring organizations should keep adequate records to document all such donations received.

Q. A sponsoring organization also prepares meals to vend to various child care centers. Some of the prepared meals are prepared for its sponsored facilities, and others are sold to child care facilities not under its auspices. What steps should be taken to protect Program integrity. How should income from the meals vended to other child care facilities be treated under the Program?

A. The sponsoring organization in question would be required to properly segregate and allocate all aspects of the vended meals. Proper cost allocation would be required for food, supplies, equipment, labor, and all administration involved in the preparation and vending of meals to child care institutions not under the sponsoring organization's auspices. The State agency should take extra care to verify that no Program money is being used to support the sponsoring organizations vending of meals to non-Program sites.

Any income the sponsoring organization receives from vending the meals must be kept separate from the Program account. This money does not have to be specifically accounted for unless it is applied to Program operations, at which point it becomes "other income" as defined by item IX D 6 b of this Instruction, and is subject to all the rules and restrictions applicable to other income.

Labor Costs.

Q. A sponsoring organization of centers and homes submits its annual budget for approval. Some of the centers are unaffiliated. Some centers purchase, others prepare their meals. Last year the centers' meal reimbursement was \$2,920,150. The day care home administrative budget was \$169,200. The salary for the CEO is \$200,000 per year. The cost allocation plan indicates the CEO spends a total of 50 percent of her time on Program activities and 50 percent of her time on non-Program activities. Is this a reasonable salary?

A. The level of compensation needs to be reasonable and commensurate with the services provided by the individual and conform to the institution's written compensation policy. In this example the organization is paying \$200,000 in annual salary to the CEO, however, only \$62,798 of which is chargeable to the CACFP if she spends 50 percent of her time on Program activities. Here's why. The Bureau of Labor Statistics indicates the salary for a public administrator is \$125,595. In this instance the state agency could approve the \$125,595 salary, which would mean \$62,798 of the CEO's salary is permitted as an allowable cost to the Program \$62,798 [$\$125,595/2 = \$62,798$]. It is an appealable action when the State agency denies approving a budget item.

In the event that the CEO were to receive \$200,000 in annual salary, each CACFP section (day care homes & centers) would only be allowed to charge \$31,399 for the CEO salary [$\$125,595/4 = \$31,399$]. The difference between the State agency approved salary and the actual salary of \$200,000 would need to be paid with non-Federal funds.

Therefore, requiring the sponsoring organization to use non-Program funds to pay for the unallowable portion of the CEO's salary will free up \$37,203 in Program funds for centers and homes, [$\$200,000 - \$125,595 = \$74,405$. $\$74,405/2 = \$37,203$], or, to view this another way, it will free up \$18,602 [$\$37,203/2 = \$18,602$] in Program funds for each section (day care homes, centers), to pay for other necessary Program costs.

Less-than-arms-length transaction.

Q. The father-in-law of an Executive Director of a CACFP sponsoring organization owns a building and uses part of the space to operate his personal business. The father-in-law leases the rest of the building to the Institution for office space. The State agency determined the rent price was allocated correctly between the two organizations. The sponsoring organization is claiming property upkeep and upgrades to the CACFP which includes \$11,000 for property taxes, \$7,000 for painting the building, \$12,000 for a new roof, and \$4,000 for resurfacing the parking lot. Are these costs allowable? In addition, the father-in-law's business is office furniture rental and the sponsoring organization leases its office furniture through the father-in-law's business. Besides this, the father-in-law also works for the sponsoring organization.

A. Before proceeding with the different issues involved in this case, you would first need to determine whether these less-than-arms-length transactions were disclosed to the State agency because this question needs to be resolved before continuing on to determining specific items of cost. The regulation at 7 CFR §226.22(d) is clear that a sponsoring organization (including employees, officers or agents of the sponsoring organization) cannot participate in selecting, awarding or administering a contract that is supported with CACFP funds where a conflict of interest, real or apparent, would be involved. The Program regulations also state that a conflict of interest would arise when

the sponsoring organization's immediate family members have a financial or other interest in the firm selected for award.

FNS Instruction 796-2, Rev. 4 expands on the CACFP regulations and provides additional information. The Instruction conveys that certain situations in which the integrity of the transaction would be compromised require special consideration (e.g., transactions between related parties). In these transactions specific prior written approval and disclosure are required.

A related party transaction is defined in this Instruction as “a transaction between the institution and its parent corporation, corporate divisions, subsidiaries, an employee(s), officer(s), agent(s) of the institution or **members of their immediate family** either directly or indirectly through corporations, trusts or similar arrangements in which they hold a controlling interest, no matter how represented. All related party transactions are less-than-arms-length transactions” (emphasis added; see Glossary).

The present Instruction clarifies that a State cannot make blanket statements that less-than-arms-length transactions are acceptable as long as they are disclosed to the State, since there are a number of considerations that must be assessed before approving such a transaction. For example, these considerations could include what type of transaction is involved, whether maximum free and open competition occurred when acquiring the good or service, whether the related costs are reasonable, etc.

Based on the limited information in the scenario above, the sponsoring organization awarded a contract for office rental space and office furniture leasing to an entity that is run by the father-in-law of the sponsoring organization's CEO. This Instruction provides the State agency an argument that such less-than-arms-length transactions **are only allowed if the transaction was approved prior to the award** as opposed to after.

The failure of the institution to identify related party transactions, less-than-arms-length transactions, ownership interests in equipment, supplies, furniture and facilities or disclose any other information to the State agency that inhibits the State agency's ability to make an informed assessment of the allowability of a particular cost will result in the disallowance of the cost and may subject the institution, its principals, employees, consultants or others to the administrative and legal remedies available to the State agency and FNS. (See *Special Considerations in Determining Allowability*, VIII C.)

The specific items of cost in question in the scenario above (i.e., property tax, painting, re-roofing, re-paving) are allowable. These types of costs are usual building-related costs and landlords typically recover such costs by passing them through to tenants in the form of rent. Allowable rental costs are restricted to “the amount that results from applying 30-year life expectancy to the property's acquisition cost less the value of land” (VIII I 36 d (3)(a)(i)). This formula amounts to a 30-year straight-line depreciation on the building's original acquisition cost.

Other considerations:

1. Depreciation is a component of rent but it is not the sole component. The landlord must also recover such building-related costs as taxes, insurance, maintenance and repair, security, interest on the mortgage if applicable, utilities (if not billed directly to tenants), etc. These costs benefit the CACFP sponsoring organization and are necessary to operate the CACFP in the landlord's premises, even if they are excluded from allowable rental cost; that is, the landlord cannot keep a roof over the sponsoring organization's head without paying required property taxes, ensuring the roof does not leak, etc.

2. Some building-related costs may rise to the level of capital expenditures by increasing the building's depreciable value beyond its original acquisition cost. U.S. GAAP call for re-figuring the annual depreciation cost in such cases in order to amortize the owner's cumulative investment in the building.

The State agency needs to notify the sponsoring organization to make a direct allocation of these costs between the sponsoring organization and the landlord's other co-located business. However, this remedy should not be applicable if the sponsoring organization failed to disclose the transaction to and obtain approval from the State agency.

Please see below for additional information on the other specific items of cost:

- Property Tax: Did the sponsoring organization contract for the office space lease include property taxes? If not, the sponsoring organization is not legally required to pay for property taxes. Are exemptions available to the building owner for property taxes (regardless if the exemption was exercised)? If so, the exemption should be applied to the property tax cost (see: VIII I 37 b(5)).
- Painting, New Roof, Resurfacing Parking Lot: These types of expenses are capital expenditures because improvements to the building materially increase the building's value or useful life. 2 CFR Part 230, Appendix B, §15(b)(3) clearly states, "Capital expenditures for improvements to land, buildings, or equipment which materially increase their value or useful life are unallowable as a direct cost except with the **prior approval of the awarding agency.**" If this is the case, then the question is: Did the State agency approve these capital expenditures, and if so, when?

The key factor to allowability of these costs is disclosure of the less-than-arms-length transaction and the specific prior approval of the State agency.

Memberships, Subscriptions and Professional Organization Activities.

Q. Is the \$300 of administrative funds available to help providers get licensed limited to only tier I providers?

A. The \$300 is available only to tier I providers. Providers can meet the income qualification for tier I by either income or area eligibility.

Q. May a sponsoring organization assist in planning an all-CACFP association meeting or training, and claim the costs as an allowable expense?

A. The travel, fees, and the time it takes to organize the training or meeting may be an allowable expense and, the SA has the authority to determine the reasonableness of the cost.

Nonprofit food service.

Q. How often should monitoring of nonprofit food service be done? What costs should be reported to the State agency when monitoring nonprofit food service?

A. The State agency needs to establish a procedure to ensure only allowable costs are reimbursed each month. The institution must maintain accounting records documenting proper cost allocation between the Program and non-Program components of its food service operation and the State agency must ensure through the review process that all CACFP reimbursements are used solely for conducting nonprofit food service operations. Nonprofit status is determined through:

a) Identifying all nonprofit food service revenues, including;

(1) CACFP reimbursements,

(2) Income to the Program, and

(3) All other funds used or restricted for use in the nonprofit food service program. These other funds may consist of donations identified for the nonprofit food service program, Head Start funds and nondiscretionary funds of the institution that must be committed to the nonprofit food service program.

b) Including only allowable net expenses incurred in the operation or improvement of the nonprofit food service program when determining food service costs;

c) Deducting allowable net expenses (identified in item b, above) from total nonprofit food service revenue (identified in item a, above);

d) Identifying the excess of all nonprofit food service revenues over nonprofit food service expenses; and

e) Verifying that any excess of revenues over expenses is retained and used only in the nonprofit food service program.

Outreach.

Q. A sponsoring organization hosts CACFP Overview sessions for potential new providers. They provide gifts such as a \$10 gift card, business calendar, and children's dishes. Can these items be charged to the Program?

A. These items are not necessary to conduct the meeting, training, or outreach activity. Unallowable participant training and support costs include social events, entertainment, flowers, table decorations, alcoholic beverages, door prizes, and gifts. Unallowable advertising and public relations costs include costs of memorabilia, such as gifts or souvenirs.

Physical Activity.

Q. Are sponsor publication, printing and reproduction costs relating to encouraging physical activity and limiting screen time of participants allowable?

A. USDA has made available to SAs, sponsors, and CACFP providers resources that can be used and/or distributed, and the Department will continue to develop new materials according to participant needs. USDA resources are free to program participants and available to download from FNS at no cost. SAs, sponsors, and CACFP providers are encouraged to use these materials first. Please see <http://healthymeals.nal.usda.gov/cacfp-wellness-resources-child-care-providers> for USDA's Team Nutrition and other resources. Costs used to reproduce and distribute USDA materials are allowable.

When these materials are not sufficient, with prior State agency approval, other materials may be developed and distributed as long as the materials emphasize the link between nutritious meals and physical activity and the costs for these materials are reasonable, necessary, and allocable as to their content in relationship to CACFP requirements.

Q. Will any physical activity equipment be considered an allowable cost?

A. Costs used to purchase or rent sports or playground equipment, equipment to measure fitness (e.g., pedometers), fitness facilities, or physical education lessons, or to purchase or subsidize regular physical activity programs, including the salaries of fitness instructors for such programs, are not allowable.

Procurement.

Q. Can an organization use non-Program funds from its nonprofit foodservice account to buy vended meals without following procurement procedures?

A. Program and other income used in the institution's food service Program can only be used for allowable Program expenses. For example, when income is generated from a fundraising event and the proceeds are used to purchase Program meals, those meals must meet all Federal requirements including being properly procured.

Q. Which entities operating under CACFP are subject to the Federal procurement principle of free and open competition?

A. Institutions are subject to 7 CFR 226.22 and therefore must conduct all procurements in accordance with 7 CFR 3016 or 7 CFR 3019. These procurement standards must be followed regardless of dollar amount, meals served or purchasing frequency.

Facilities are not required by regulation or policy to conduct procurements that uphold free and open competition; i.e., they are free to purchase food and other items according to their own practices. Facilities can be DCHs, affiliated centers, or unaffiliated centers that have an agreement with a sponsoring organization (an institution).

Rental Costs.

Q. What is needed when determining the reasonableness for all rental costs?

A. One should consider whether the rental costs are being offered at the fair market price. Additionally, the compliance of the contractual documents to the applicable procurement requirements; the type, life expectancy, condition and value of the property or item; and the benefits received by the Program in relation to the cost to the Program.

Training.

Q. May the cost of a motivational speaker be charged to the Program?

A. Motivational speakers are an unallowable Participant Training and Other Participant Support Costs.

Q. What kind of training related to physical activity or to limiting the screen time of participants will sponsors be allowed to conduct with their nonprofit food service account funding?

A. Training related to physical activity or to limiting the screen time of participants is treated in the same way as other allowable meeting and conference costs (See VIII, I, 28 of this Instruction for more information on meetings and conferences). With prior State agency approval, sponsors may use nonprofit food service account funds to pay for training programs and technical assistance focused on CACFP requirements which include encouraging physical activities, limiting screen time, and which emphasize the linkage between nutritious meals and physical activity for the overall well-being of children. This likewise allows for the cost of distributing educational materials related for these training and technical assistance sessions.

Travel.

Q. Are odometer readings required to document mileage when mileage costs are charged to the Program?

A. Odometer readings are not required to document mileage; however, the State agency must identify a method for documenting mileage costs charged to the Program.