

# **MAINTAINING AN INFRASTRUCTURE FOR THE DEVELOPMENT OF COST ALLOCATION PLANS (CAPS)**

**ATI-0007-2015**



**PUERTO RICO INTEGRATED TRANSIT AUTHORITY (PRITA)**

*FINANCIAL OPERATIONS POLICIES AND PROCEDURES*

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Regulation Number or Procedure:

ATI-0007-2015

DEPARTAMENTO DE TRANSPORTACIÓN Y OBRAS PÚBLICAS

PUERTO RICO INTEGRATED TRANSIT AUTHORITY (PRITA)

Title regulation or procedure:

**MAINTAINING AN INFRASTRUCTURE  
FOR THE DEVELOPMENT OF COST  
ALLOCATION PLANS (CAPS)**

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**Administration and  
Finance**

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Directors: **12-17-2015**

Notes:

## 1 Purpose

The purpose of these desk procedures is to provide guidance so that adequate controls are in place to account for the appropriate processing of any overhead or indirect cost related to Federal grants/projects for the Authority. These procedures support the regulations and guidance (circulars and bulletins) issued by the U.S. Department of Transportation (DOT) – Federal Transit Administration (FTA), other Federal agencies, the Office of Management and Budget, the enabling Act of the Authority and the Commonwealth Government of Puerto Rico.

Cost allocation is the assigning of a common cost to several cost objects. For example, the Authority might allocate or assign the cost of an expensive computer system to other main areas that use the system. A government entity might allocate the cost of management (e.g. Governor, Mayor, Board, etc.) to the various departments in the government that benefit from the activities of the management. Some have described the allocation process as the spreading of cost. Efforts have been made over the years to improve the bases for allocation. In manufacturing, the overhead allocations have moved from plant-wide rates to departmental rates, from direct labor hours to machine hours to activity based costing. The goal is to allocate or assign the costs based on the root causes of the common costs instead of merely spreading the costs.



The Authority may receive allocations of costs from other departments or the Central Puerto Rican Government, or may elect to charge overhead, administrative or fringe benefit costs to Federal grants in an indirect allocation. When these circumstances arise, the Authority must have a specific set of policies and procedures to allow it to prepare, submit and request reimbursement for these costs.

To meet this objective, the Authority will have an organized plan both internally and with the rest of the Puerto Rican Government. Similar to any costs the Authority may request reimbursement for; it must provide adequate supporting documentation for these indirect costs. The Authority will follow the guidance of 2 CFR Part 225, Cost Principles for State, Local and Indian Tribal Governments (formerly OMB Circular A-87) in preparing and submitting any cost allocation plan it may prepare.

The Authority utilizes numerous estimates in the preparation of its interim and annual financial statements. It is its policy that all such estimates shall be reassessed, reviewed, and approved by the Chief Financial Officer on an annual basis. Documentation shall be maintained supporting all key conclusions, bases, and other elements associated with each accounting estimate. All material estimates, and changes in estimates from one year to the next shall be disclosed to Authority's external audit firms. Some of those estimates include:

- Useful lives of property and equipment
- Adequacy of receivables
- Fair market values of investments
- Values of contributed services
- Allocations of income between departments/programs
- Joint cost allocations
- Allocations of indirect costs
- Allocations of time/salaries

These procedures provide the general standards, specific standards and guidance and the responsibilities of designated offices and positions for the preparation and administration of cost allocation plans.

## 2 Scope and Applicability

The Office of Management and Budget (OMB) relocated Circular A-87, “Cost Principles for State, Local, and Indian Tribal Governments,” to Title 2 in the Code of Federal Regulations (2 CFR), Subtitle A, Chapter II, part 225 as part of an initiative to provide the public with a central location for Federal government policies on grants and other financial assistance and non-procurement agreements. Consolidating the OMB guidance and co-locating Authority’s regulations provides a good foundation for streamlining and simplifying the policy framework for grants and agreements as part of the efforts to implement the Federal Financial Assistance Management Improvement Act of 1999 (Pub. L. 106-107).

This part establishes principles and standards to provide a uniform approach for determining costs and to promote effective program delivery, efficiency, and better relationships between governmental units and the Federal Government. The principles are for determining allowable costs only. They are not intended to identify the circumstances or to dictate the extent of Federal and governmental unit participation in the financing of a particular Federal award. Provisions for profit or other increment above cost is outside the scope of this part.

The applicability of the Authority’s cost allocation guidance and procedures is to ensure the accurate identification of costs in conjunction with the current accounting system and related programs and organization. The process includes the steps to identify costs as direct or indirect, and the effectiveness of developing and administering an allocation plan to equitably allocate costs to the benefitting activities. This is achieved by planning and a commitment to certain basic cost principles including GAAP and Federal Cost Principles. Some of the key elements for consideration include:

- Reasonableness;
- Allocability;
- Allowability;
- Reimbursable;
- Direct vs. Indirect; and
- Consistency

These procedures will also include peripheral guidance on adequacy of segregation of duties related to the cost allocation plan processes.

This document contains specific financial guidance and accounting standards relating to cost allocation and related indirect rate plans. The guidance and standards are deliberately broad; keeping duplication of policy and procedural material readily available from Authority’s central administrative entities. This section establishes guidance and standards that are



specific to Authority's needs, financial systems, and program requirements, with particular emphasis on the operational requirements of the accounting systems.

General cost principles are included in the standards promulgated by the Government Accounting Standards Board (GASB). Specific cost allocation plan principles are included as part of the overall Cost Principles established by the Federal government. For the Authority, these are included in 2 CFR Part 225.

Types of allocation plans that may be used by the Authority include Central Service Cost Allocation Plans (related to costs allocated from the Central PR Government to the operating Bureaus/Offices, and from the Authority to its operating departments and Indirect Cost Allocation Plans, whereby indirect costs are allocated to specific projects and grants for the purpose of reimbursement.

### 3 Objective:

To ensure adequate controls are in place so that any overhead or indirect cost applied to Federal grants/projects are appropriate.

#### Specifically, to ensure that:

- All overhead costs charged to Federal grants are reasonable, allowable, and allocable.
- Indirect cost allocation procedures are adequate to ensure that only appropriate costs are being charged to grant-funded capital projects.
- Job cost allocation procedures are adequate to ensure that only appropriate direct costs are being charged to grant-funded capital projects.

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### 4 Segregation of Duties

The segregation of functions or duties is an important element in any system of internal control. For accounting control purposes, incompatible functions are those that place any person in a position to both perpetrate and conceal errors or irregularities in the normal course of their job.

Accounting controls should also ensure that transactions are: (1) recorded in the proper amounts, (2) recorded in the accounting periods to which they apply, and (3) classified in appropriate accounts.

This is especially important in order to ensure the accurate preparation of Cost Allocation Plans in conformity with Federal government rules and regulations and generally accepted accounting principles (GAAP).

## 5 Reviewing Infrastructure for Cost Allocation Plan (CAP) Development:

### 5.1 Determine if CAP is beneficial

When considering if a cost allocation plan needs to be developed, several key factors must be evaluated:

- Are the costs resulting from the plan going to be reimbursed/increase revenue?
- What is the total value of the net reimbursement? Is the cost of the plan development worth it?
- Do we have adequate accounting detail to support the allocation?
- Are there GAAP or GASB) regulatory limitations that will prevent the plan from being implemented?
- What types of costs are being allocated?
  - Central Service;
  - Fringe Benefits;
  - General Admin;
  - Facilities; and
  - Other overhead.

### 5.2 The Accounting System and its support for administering the CAP

A cost allocation plan and related indirect cost rate is simply a device for determining fairly and conveniently within the boundaries of sound administrative principles, what proportion of direct and indirect costs each program should bear. An indirect cost rate is the ratio between the total indirect expenses and some direct cost base.

The Cognizant Agency<sup>1</sup> typically issues provisional and final indirect cost rates. There are also predetermined and fixed rates, but are rarely used. All of these rates are described below, per 2 CFR Part 225:

- *Provisional rate or billing rate* means a temporary indirect cost rate applicable to a specified period which is used for funding, interim reimbursement and reporting indirect costs on awards pending the establishment of a final rate for the period.

<sup>1</sup> As defined by 48 CFR 2.101 the Federal agency that, on behalf of all Federal agencies, is responsible for establishing final indirect cost rates and forward pricing rates, if applicable, and administering cost accounting standards for all contracts in a business unit. Unless different arrangements are agreed to by the agencies concerned, the Federal agency with the largest dollar value of awards will be designated as the *cognizant agency* for the negotiation and approval of indirect cost rates.



- *Final rate* means an indirect cost rate applicable to a specified past period which is based on the actual costs of the period. A final rate is not subject to adjustment.
  - Note that a final indirect cost rate is established after an organization's actual costs are known, typically a fiscal year. Once established, a *final* indirect cost rate is used to adjust the indirect costs claimed.
  - The use of provisional and final rates will likely result in final audited expenditures being higher or lower than those reported for awards, which are terminated during the organization's fiscal year. A final rate may be issued as a provisional rate in the ensuing year, adjusted for anticipated changes in funding levels or costs.
- *Predetermined Rate*: A permanent rate established for a specified current or future period and is not subject to adjustment. A predetermined rate may be used on awards where there is reasonable assurance that the rate is not likely to exceed a rate based on the organization's actual costs,
- *Fixed Rates with carry-forward*: A permanent rate is established for a future prospective period of time used for budgeting, obligations, and payment of funds by awarding agencies. Actual costs are determined by the organization's accounting system and the difference between fixed and actual is carried forward to a future period usually the organization's fiscal year, in order to adjust the fixed rate for any over or under recovery.

*Provisional and final rates* are preferred by most organizations for the following reasons:

- Actual indirect costs are allocated to program objectives in the year incurred, creating accurate cost information;
- There are no prior year indirect costs carried into a future year to burden new or continuing funding;
- All indirect costs are properly funded in the fiscal year incurred, creating no profit or loss for the organization;
- The organization's accounting system must determine actual costs each year, a capability that ultimately must exist to synchronize accounting, budgeting, and cost allocation; and
- The actual cost of services or programs is determined annually and is therefore available for purposes of internal management and informed budgeting.

### 5.3 Methods of Determining Indirect Costs Rates and Cost Allocation

The three basic methods for calculating indirect cost rates under 2 CFR Part 225 is the:

- Simplified,
- Multiple Rate, and
- Direct Allocation methods



Specific instructions on the computation of indirect cost rates with the conditions on when to use each method are contained in 2 CFR Part 225, Appendices C, D, & E. 2 CFR Part 225 also provides for the use of Special Indirect Cost Rates. A single indirect cost rate for all activities of the organization may not be appropriate when work under the Federal program is conducted in an offsite location and the level of administrative support is different than other programs.

The total amount claimable under a cost-based award covered by 2 CFR Part 225 equals the allowable direct costs, plus the allocable portion of allowable indirect costs, minus the applicable credits.

Direct costs are cost that can be readily assigned to a particular cost objective with a high degree of accuracy. Indirect costs are those that cannot be readily assigned to a particular cost objective without effort disproportionate to the benefits received. However, the Circular permits minor direct cost items to be treated as indirect costs for practicality, so long as consistent treatment of all such items is maintained.

Applicable credits are receipts or reductions of expenditure that offset or reduce costs allocable to Federal awards as direct or indirect costs. These are to be credited to the cost objective or the award, or refunded to the awarding agency, depending upon the circumstances and the timing of their accrual or receipt.

## 5.4 Are Costs Allowable, Allocable, Reasonable and treated Consistently

### 5.4.1 General Tests of Cost Allowability

Although Appendix B of 2 CFR Part 225 lists a number of selected items of cost which frequently represent significant amounts in individual Federal awards or are costs for which there is a specific Federal policy, Appendix A establishes general tests of allowability that apply irrespective of whether a particular item of cost is specifically mentioned in Appendix B. These general tests frequently involve judgment and an assessment of the facts and circumstances in which the specific cost is incurred. The tests are not only listed in the Circular itself, but are frequently restated in compliance audit guidance that Federal and nonfederal auditors use to carry out field work and reporting.

The general tests of allowability are that the cost:

- be authorized or not prohibited under state or local laws or regulations — a governmental unit may not accept and expend Federal funds to undertake an activity for which it does not have the authority under its own state or local law or which would constitute an illegal purpose;

- conform to any limitations or exclusions set forth in the cost principles, Federal laws, terms and conditions of the Federal award, or other governing regulations as to types or amounts of cost items;
- be consistent with policies, regulations, and procedures that apply uniformly to both Federal awards and other activities of the governmental unit;
- be accorded consistent treatment — a cost may not be assigned to a Federal award as a direct cost if any other cost incurred for the same purpose in like circumstances has been allocated to the Federal award as an indirect cost;
- be determined in accordance with generally accepted accounting principles (GAAP), except as otherwise provided for in 2 CFR Part 225;
- not be included as a cost or used to meet cost-sharing or matching requirements of any other Federal award in either the current or a prior period, except as specifically provided by Federal law or regulation; be net of all applicable credits; and
- be adequately documented.

#### 5.4.2 General Tests of Cost Allocability

The second general test of allowability is that the cost be allocable to Federal awards under the provisions of 2 CFR Part 225. A cost is **allocable** to a particular cost objective if the goods or services involved are chargeable or assignable to that cost objective according to the relative benefits received. All activities which benefit from the governmental unit's indirect costs, including unallowable activities and services donated to the governmental unit by third parties, will receive an appropriate allocation of indirect costs.

Any cost allocable to a particular Federal award or cost objective under the principles in 2 CFR Part 225 may not be charged to other Federal awards to overcome fund deficiencies, to avoid restrictions imposed by law or terms of the Federal awards, or for other reasons. Such a practice constitutes unallowable cost shifting. However, this prohibition does not preclude governmental units from charging costs that are allowable and allocable under two or more awards, pursuant to existing program agreements. Such charges are viewed as "funding allocations" rather than cost allocations.

Where an accumulation of indirect costs will ultimately result in charges to a Federal award, a cost allocation plan or indirect cost rate agreement will be required.

In general, to meet the test of adequate documentation of charges under a Federal award, a governmental unit must document charges in a manner consistent with documenting expenditures of its own source revenue. However, certain provisions of 2 CFR Part 225 and the Common Rule issued pursuant to OMB Circular A-102 provide for specific standards for certain types of costs. For example, 2 CFR Part 225 addresses documentation for employee compensation, depreciation or use allowance for assets, and various types of allocated and billed indirect costs. The A-102 Common Rule establishes documentation requirements for purchase transactions (§ 36 (b) (9)).



### 5.4.3 General Tests of Necessary and Reasonable Costs

The first general test of allowability is that the cost be necessary and reasonable for proper and efficient performance and administration of Federal awards. A cost is **reasonable** if, in its nature and amount, it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the cost. The question of reasonableness is particularly important when governmental units or components are predominately federally funded. In determining reasonableness of a given cost, consideration should be given to:

- The cost is of a type generally recognized as ordinary and necessary for the operation of the governmental unit or the performance of the Federal award;
- The restraints or requirements imposed by such factors as sound business practices; arms-length bargaining; Federal, state, and other laws and regulations; and Federal award terms and conditions;
- The market prices for comparable goods or services;
- The individuals – whether they acted with prudence in the circumstances, considering their responsibilities to the governmental unit, its employees, the public at large, and the Federal Government; and
- A significant deviation from the established practices of the governmental unit which may unjustifiably increase the Federal award's cost.

### 5.4.4 General Tests of Consistent Treatment of Costs

Costs must be treated consistently in accordance with the organization's established accounting system without regard to the source of funds supporting the expenditures. This means that costs incurred for the same purpose in like circumstances must be treated consistently as either direct or indirect.

## 6 Required Government Certification:

No cost allocation plan or indirect cost rate will be approved by the Federal Government unless the plan or rate proposal has been certified by the governmental unit. Except as noted below, no indirect costs will be reimbursed unless the governmental unit has an approved rate/plan or maintains on file a certified plan/rate, as appropriate.

The Federal Government may unilaterally establish such a cost allocation plan or indirect cost rate. Such a plan or rate may be based upon audited historical data or such other data that have been

furnished to the corresponding Federal agency and for which it can be demonstrated that all unallowable costs have been excluded. When a cost allocation plan or indirect cost rate is unilaterally established by the Federal Government because of failure of the governmental unit to submit a certified proposal, the plan or rate will be established to ensure that potentially unallowable costs will not be reimbursed.

## 7 Determining the Correct Allocation Bases:

### 7.1 Suggested Bases for Cost Distribution

Listed below are suggested bases for distributing joint costs of central-type services to local government departments or agencies and to projects and programs utilizing these services. The bases are suggestions only, and should not be used if they are not suitable for the particular services involved. Any method of distribution can be used which will produce an equitable distribution of cost. In selecting one method over another, consideration should be given to the additional effort required to achieve a greater degree of accuracy.

Type of Service	Suggested Bases for Allocation
	Number of transactions processed
Accounting	
Auditing	Direct audit hours
Budgeting	Direct hours of identifiable services of employees of central budget
Buildings lease management	Number of leases
Data processing	System usage
Disbursing service	Number of checks or warrants issued
Employees retirement system	Number of employees contributing administration
Insurance management service	Dollar value of insurance premiums
Legal services	Direct hours
Mail and messenger service	Number of documents handled or employees served
Motor pool costs	Miles driven and/or days used
Office machines and equipment	Direct hours maintenance repairs
Office space use and related costs	Square feet of space occupied (heat, light, janitorial services, etc.)
Organization and management	Direct hours; Square feet services
Payroll services	Number of employees

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Personnel administration	Number of employees
Printing and reproduction	Direct hours, job basis, pages printed, etc.
Procurement service	Number of transactions processed
Local telephone	Number of telephone instruments
Health services	Number of employees
Fidelity bonding program	Employees subject to bond or penalty amounts

For the Allocation of pools of costs to the final objective, 2 CFR Part 225 suggests, with few exceptions, that the allocation base be either total direct costs or total direct labor. For Fringe Benefit Rates the allocation base MUST be total direct labor.

## 8 Summary

In summary, as the Authority discusses whether a Cost Allocation Plan is best suited to capture and invoice their indirect cost, these procedures will provide valuable assistance in both making those decisions as well as ensuring that the accounting and other systems are set up to manage the CAP information before they plan to submit their CAP to their cognizant agency.

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## 9 ADOPTED & VALIDATE BY:



17th of December, 2015

Juan A. Vázquez Acevedo  
Chief Financial Officer,  
Puerto Rico Integrated Transit Authority (The Authority)

DATE

## 10 EFFECTIVENESS, REPEAL AND APPROVAL

This procedure, shall be valid from the date of approval by the Board of Directors of the Puerto Rico Integrated Transit Authority.



17th of December, 2015

Alberto M. Figueroa Medina, PhD, PE  
**Executive Director**  
Puerto Rico Integrated Transit Authority

DATE

Duly approved by the Board of Directors of the Puerto Rico Integrated Transit Authority, in regular meeting held on the 17th of December, 2015



17th of December, 2015

Miguel A. Torres Díaz  
**Chairman of the Board**  
Puerto Rico Integrated Transit Authority

DATE

