

# **Handbook of Cost Plan Procedures for California Counties**



**California State Controller's Office**

**March 2024**

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# Introduction

The State Controller's Office (SCO) has developed this handbook to assist California counties in the understanding and the application of the cost principles and standards established by the Federal Office of Management and Budget Rules and Regulations Title 2, *Code of Federal Regulations*, Part 200 (2 CFR Part 200) (former titles 2 CFR Part 225 and OMB A-87) for state and local governments and federally-recognized Indian tribal governments (governmental units). This handbook contains the latest policies and procedures for the preparation and application of Countywide Cost Allocation Plans. It is intended to be used in conjunction with 2 CFR Part 200 and Assistant Secretary Management and Budget Cost Principles and Agreements with the Federal Government (ASMB C-10), issued by the Department of Health and Human Services.

Federal costing principles are intended to apply to the 50 states and to thousands of local governmental jurisdictions across the country. Consequently, the cost principles promulgated by 2 CFR Part 200 are designed to be generally applicable to all non-federal entities for determining costs for federal awards carried out through grants, cost reimbursement contracts, and any other agreements with the federal government.

This handbook was developed to provide guidance in interpreting the federal cost principles from 2 CFR Part 200 when considering the following two questions:

- Do the total costs accumulated for a central service department reasonably reflect the value of services provided by that department?
- Do costs that are distributed and/or billed to each operating receiving department equitably reflect the value of the services received by these departments?

This handbook is divided into four parts: Part I, Development, Approval, and Use of a Countywide Cost Plan; Part II, Preparation Requirements for Cost Plans; Part III, Guidelines for Grant Reimbursement of Space Costs; and Part IV, Guidelines for Grant Reimbursement of Self Insurance Program Costs. Each part of this handbook is preceded by a separate table of contents and consists of several sections, exhibits, sample forms, and glossaries.

The SCO is available to assist counties with any cost plan issues, questions, and concerns. Comments and suggestions are always welcome. Please contact your county's assigned cost plan analyst or email the County Cost Plans Unit at [LGPSDCountyCostPlans@sco.ca.gov](mailto:LGPSDCountyCostPlans@sco.ca.gov). You can also write to us at the following address:

State Controller's Office  
Local Government Programs and Services Division  
Local Government Policy Section  
County Cost Plans Unit, Suite 740  
P.O. Box 942850  
Sacramento, CA 94250

# March 2024 Revision: List of Substantive Changes

1. **Erratum to County Fiscal Letter (CFL) 20/21-106**
  - a. Please see Section 3320: Reimbursement Methods – Leases
2. **Impact of Governmental Accounting Standards Board Statement 87 and Governmental Accounting Standards Board Statement 96 on the Allowability of Leases in Countywide Cost Allocation Plans**
  - a. Please see Section 3340: Allowability of Leases
3. **Please visit the “Forms” section of the [County Cost Plans Unit website](#) for the latest version of the following supplemental documents:**
  - a. Exhibit 1303 — Supplemental Information Checklist
  - b. Exhibit 1304 — Pension Obligation Bond Certification
  - c. Exhibit 1305 — Administrative Expense Claims Certification
  - d. Exhibit 1401 — Certificate of Cost Allocation Plan
  - e. Exhibit 4401 — Self Insurance Data Sheet

## **Section 1100: Responsibility for Cost Plans**

The current Federal Office of Management and Budget Circular *Title 2 Code of Federal Regulations* (2 CFR Part 200) [formerly known as 2 CFR Part 225 and OMB A-87] is titled *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards*. This part establishes principles and standards to provide a uniform approach for determining costs and to promote effective program delivery and efficiency, as well as 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. Provision for profit or other increment above cost is outside the scope of this part. All federal agencies apply the principles in 2 CFR Part 200 in determining reimbursable costs incurred by non-federal entities under federal awards and sub-awards. 2 CFR Part 200 is available at [Electronic Code of Federal Regulations](#).

### **Section 1110: Cognizant Agency Concept**

The term “cognizant agency” as used in 2 CFR Part 200 refers to any agency that is responsible for reviewing, negotiating, and approving, on behalf of all federal agencies, cost allocation plans or indirect cost proposals developed under 2 CFR Part 200.

Under 2 CFR Part 200, the Federal Department of Health and Human Services (HHS) has cognizance for negotiated statewide cost allocation plans for all 50 states, the District of Columbia, and Puerto Rico.

In discharging its responsibilities as a principal cognizant agency, HHS’ Office of Audit Resolution and Cost Policy, in the Office of Grants and Acquisition Management, developed brochure [Cost Principles and Procedures for Developing Cost Allocation Plans and Indirect Cost Rates for Agreements with the Federal Government](#). This brochure describes in general terms the process of indirect cost determination, including guidance on the preparation and submission of cost allocation proposals by state and local governments.

### **Section 1120: Assignment of Cognizant Agencies**

Unless different arrangements are agreed to by the concerned federal agencies, the cognizant agency responsible for review and approval of local government central service cost allocation plans is the federal agency with the largest dollar value of total federal awards (including pass-through funds). Cognizant agency assignments do not change more frequently than every five years. Based on the preponderance of funding over the last several years, HHS remains the federal cognizant agency for all California county cost allocation plans.

Governmental units that have questions on cognizance should contact the federal agency that has the major dollar involvement in the non-federal entity’s programs or the [Office of Federal Financial Management, Accountability, Performance, and Reporting Branch](#), OMB, Washington, DC, 20503; telephone: (202) 395-3993.

### **Section 1130: Delegation of Cognizant Authority**

The HHS may delegate to a state the responsibility of approving local government cost allocation plans. When a state is assigned delegated cognizance, it becomes the authorized representative of the HHS and can review, negotiate, and approve local government cost allocation plans on behalf of that agency.

In December 1971, the HHS delegated cognizance authority for California counties to the Director of the California Department of Social Services (CDSS). In January 1974, HHS re-delegated this authority to the SCO, where it has remained. Inherent in this delegation is authority to review, negotiate, and approve countywide cost allocation plans for California counties in accordance with 2 CFR Part 200. This delegation of authority includes the responsibility to develop and disseminate information to supplement existing cost plan instructions, as well as the authority to review and approve procedures and methodologies used by counties for direct billing of central services. This authority does not include the responsibility for approving indirect cost rate proposals (ICRPs) of county departments.

The SCO, under its delegated cognizance, acts on behalf of the HHS in cost plan matters. As the agency assigned cognizance for California counties, the SCO has the authority to modify, expand, or reduce 2 CFR Part 200 documentation requirements and to request additional information related to submitted county cost plans.

### **Section 1140: Cognizance for State Agency Purposes**

At this time, no agency is designated to act as the cognizant agency for all state grants and contracts. Currently, any state department reimbursing counties with federal flow-through funds must recognize and accept the countywide cost allocation plan as approved by the SCO. In most cases, these departments accept the same plan for identifying and reimbursing the costs associated with the State's share of the federally funded program. In some instances, state departments that have no federal flow-through funds also accept the cost plan for indirect cost reimbursement purposes.

Some state departments do not recognize costs approved by the SCO when reimbursing indirect costs related to their programs. Until the State Legislature passes or the Governor's Office issues a resolution decreeing that all state agency secretaries will direct their departments to accept countywide cost allocation plans as approved by the SCO for indirect cost reimbursement, this office does not have cognizance in this area.

### **Section 1150: Approval of Cost Plans**

Countywide cost allocation plans have been submitted for review and approval by the SCO since 1974. Since this time, each California county has been required to have received from the SCO either a provisionally or formally approved countywide cost allocation plan before any indirect costs or direct billings for central support services may be reimbursed by state and federal agencies.

### **Section 1160: Cost Plans Submittal Timeframe**

All cost plans must be submitted to the SCO at least six months prior to the fiscal year for which the plans are to be used. For example, cost plans for fiscal year (FY) 2023-2024 used the actual costs of the 2021-2022 fiscal year as estimated costs, and were required to be submitted to the SCO no later than December 31, 2022 (six months before the date the plans became effective).

### **Section 1170: Estimated (Fixed) Cost Plans**

Any county wishing to submit a separate estimated (fixed) cost plan for use in a forthcoming fiscal year must be aware of the following requirements:

- The application of across-the-board inflation factors is not to be allowed in the preparation of estimated (fixed) cost plans used for claiming.
- The use of separate estimated (fixed) cost plans for use in claiming is allowed, provided the county has received prior written approval for the use of this type of plan from the SCO.
- Estimated (fixed) cost plans are due to the SCO six months prior to the start of the fiscal year in which they are to be used, unless a written request for an extension is received by the SCO, as described in Section 1180 of this handbook.
- When a separate estimated (fixed) cost plan is prepared, the county may use the appropriations adopted by the county board of supervisors in the final budget adopted and approved for use in the current fiscal year. Any salary and wage increases for the fiscal year in which the plan will be used may be added to these appropriations if the increases have been approved and adopted by the county board of supervisors.
- If the county wishes to add salary and wage increases to its estimated (fixed) cost plan, it must describe its intention to do so in a letter to the SCO requesting the use of separate estimated plan. Minutes of the board of supervisors meeting that support the amounts of any planned increases must be provided.
- If the use of a separate estimated (fixed) cost plan is approved, an actual (final) cost plan must be prepared and submitted to the SCO within six months of the close of the actual fiscal year of use. Any differences between the estimated and actual costs will be carried forward into a cost plan used in a future year.

For example, a county could have used the approved and adopted appropriations of the FY 2021-2022 as an estimate for the FY 2022-2023. This estimate could have been increased by the amounts of any negotiated salary and wage increase taken place in the FY 2022-2023, as long as this increase had been approved and adopted by the county board of supervisors prior to the county's completion of the estimated FY 2022-2023 cost plan. Actual costs for FY 2022-2023 would have been due to the SCO no later than December 31, 2022.

### **Section 1180: Requesting a Deadline Extension**

If a cost plan cannot be submitted to the SCO by December 31<sup>st</sup>, an extension request, in the form of a letter, explaining the reasons the plan cannot be submitted by the due date must be submitted by November 30<sup>th</sup>. If the stated reasons are acceptable, the SCO will send a letter approving an extension of the deadline. If an extension letter is not received by November 30<sup>th</sup>, or if the justifications for the extension are not reasonable, an extension may not be granted.

Timely preparation of the countywide cost plan ensures that reliable cost information will be available for use in budget preparation. A cost plan provides information that is necessary for the preparation of departmental indirect cost proposals, and it ensures that there will be no delay in the payment of claims submitted by county departments for reimbursable costs.

### **Section 1195: Where to Submit Countywide Cost Allocation Plans**

All countywide cost allocation plans must be submitted to the SCO for approval prior to use. Hard copies of the cost plan, supplemental documents, or any other documentation is not required. Electronic/soft copies of all documentation is sufficient and preferred. Please submit all documents to [LGPSDCountyCostPlans@sco.ca.gov](mailto:LGPSDCountyCostPlans@sco.ca.gov).

The mailing address is:

State Controller's Office  
Local Government Programs and Services Division  
Local Government Policy Section  
County Cost Plans Unit, Suite 740  
P.O. Box 942850  
Sacramento, CA 94250

## **Section 1200: Cost Plan Development Concepts**

There are three types of costs experienced by any department in conducting its operations: direct costs, indirect costs, and central service costs. The first step in developing a cost allocation plan is to examine the interrelationships between the various county departments.

### **Section 1210: Direct Costs Defined**

Direct costs, as defined in 2 CFR Part 200, Section 200.413, are costs that can be identified specifically with a particular final cost objective, such as a federal award, or other internally or externally funded activity, or that can be directly assigned to such activities relatively easily with a high degree of accuracy. 2 CFR Part 200, 200.413 notes that typical direct costs chargeable to federal awards are:

1. Compensation of employees who work on that award, their related fringe benefit costs; and
2. Cost of materials and other items of expense incurred for the Federal award.

A grantee department may receive a service furnished specifically for a particular grant function from another department. The allowable direct costs associated with the department providing this service, plus a proportionate share of the allowable supporting costs and supervision directly related to the service, would be considered direct costs of the grantee department.

### **Section 1220: Indirect Costs Defined**

2 CFR Part 200, Section 200.56, defines indirect costs as those costs that are:

1. Incurred for a common or joint purpose benefitting more than one cost objective; and
2. Not readily assignable to the cost objectives specifically benefitted, without effort disproportionate to the results achieved.

This same section also states:

“To facilitate equitable distribution of indirect expenses to the cost objectives served, it may be necessary to establish a number of pools of indirect (F&A) costs. Indirect (F&A) cost pools should be distributed to benefitted cost objectives on bases that will produce an equitable result in consideration of relative benefits derived.”

### **Section 1230: Central Services Costs Defined**

All county departments may receive “central services” from other county departments. 2 CFR Part 200 addresses billed central services and allocated central services. 2 CFR Part 200 Appendix V, Section B, provides the following definitions:

1. “Billed central services” means central services that are billed to benefitted agencies and/or programs on an individual fee-for-service or a similar basis. Typical examples of

billed central services include computer services, transportation services, insurance and fringe benefits.

2. “Allocated central services” means central services that benefit operating agencies but are not billed to the agencies on a fee-for-service or a similar basis. These costs are allocated to benefitted agencies on some reasonable basis. Examples of such services might include general accounting, personnel administration, purchasing, and similar activities and support functions necessary to sustain the direct effort involved in administering a grant program or an activity providing service to the grant program.

The examples of “central services” provided are not all-inclusive and should not be construed to preclude other functions from being considered indirect or central services. Ordinarily, the functions mentioned above would be centralized in a department or budget unit outside of the grantee department’s organization structure.

### **Section 1240: Cost Plan Defined**

Before indirect costs and central service charges may be claimed for reimbursement by a grantee department, there must be formal means of accumulating and identifying these types of costs to all benefitting departments. Regardless of whether or not a county has a formal comprehensive cost accounting system, the best method of accumulating and identifying indirect costs is a cost allocation plan prepared in accordance with the cost principles set forth in 2 CFR Part 200, ASMB C-10, and this handbook.

A cost plan identifies and assigns central service costs to benefitted agencies by a reasonable and consistent basis. All costs and other data used to distribute the costs included in a cost allocation plan must be supported by formal accounting records and other data that will corroborate the propriety and accuracy of costs assigned to federal awards. The central service cost allocation plan contains the documentation identifying, accumulating, and distributing allowable costs to operating departments, including grantee departments, together with the allocation methods used.

### **Section 1250: Cost Summary/Exhibit and Accounting System Interface**

When the cost plan format is used for identification of indirect and central support service costs associated with the various operating and grantee departments, the resulting product will be a cost summary or cost exhibit. These two terms are synonymous and may be used interchangeably. A cost exhibit or cost summary identifies the unbilled portion of indirect costs to the departments that will receive services from the departments whose costs are included in the plan in the fiscal year that the plan addresses. Adjustments, corrections, and other cost considerations that affect prior years can also be included in this exhibit.

The accounting system of the agency preparing a cost plan must be able to track the actual costs that occur during each fiscal year. This is necessary so that the actual costs can be determined at a later date, and so that any required adjustments made to cost plan expenditure allocations in subsequent cost plans can be identified.



If a local government uses a formal cost accounting system, the direct costs accounted for by that system should be reported in a manner that reflects the cost principles set forth in 2 CFR Part 200, ASMB C-10, and this handbook. This formal cost accounting system is intended to ensure that the resulting identification of costs to all operating departments will be in accordance with federal cost reimbursement principles.

**Section 1260: Use of Cost Summary/Exhibit**

Any claims made by a grantee department for indirect costs should be based upon the cost summary/exhibit. The cost summary/exhibit provides a basis for charging users of county central services, including services to outside agencies, for example, auditing services provided by a county auditor-controller to a special district. Claims for reimbursement must include a review of direct charges to the grantee departments in the county's accounting system in order to avoid a situation in which a cost is considered as an indirect cost allocated in the cost plan as well as a direct cost.

**Exhibit 1201: Cost Summary/Exhibit**

Central Service Department	30000 Board of Sup.	392100 Social Svcs.	40100 Child Support	405000 Health Admin.	99999 All Others	Subtotal	Direct Billed	Unallocated	Total
000001 Building Depr.	10,775	47,586	0	32,499	47,602	138,462	0	0	138,462
000002 Equipment Depr.	4,888	0	0	24,132	0	29,020	0	0	29,020
120000 Auditor	10,701	210,451	39,345	18,817	119,611	398,925	19,652	719,373	1,137,950
180000 CAO	240,959	236,970	53,074	40,277	127,714	698,994	7,999	450,235	1,157,228
240000 County Counsel	313,716	211,008	5,412	81,589	64,241	675,966	1,009,226	0	1,685,192
303000 Comm. Tech.	0	5,024	45	4,054	154,987	164,110	0	0	164,110
331000 General Services	21,134	4,314	40,421	53,757	36,501	156,127	1,784,509	0	1,940,636
333000 Facilities Mgmt.	40,542	50,587	0	108,679	225,363	425,171	3,087,642	0	3,512,813
334100 Purchasing	0	27,257	0	0	54,879	82,136	450,147	0	532,283
334200 Stores	0	3,670	0	0	25,321	28,991	0	0	28,991
490000 Parks & Rec.	0	35,595	0	0	76,248	111,843	0	0	111,843
510000 Personnel	13,788	81,573	27,373	45,908	125,963	294,605	67,869	634,028	996,502
515202 General Insurance	1,886	6,718	889	2,497	0	11,990	77,246	0	89,236
730000 Treasurer	0	88,519	0	0	149	88,668	14,910	9,488	113,066
<b>Total Allocated</b>	<b>658,389</b>	<b>1,009,272</b>	<b>166,559</b>	<b>412,209</b>	<b>1,058,579</b>	<b>3,305,008</b>	<b>6,519,200</b>	<b>1,813,124</b>	<b>11,637,332</b>
<b>Carry-Forward</b>	<b>5,551</b>	<b>219,007</b>	<b>(6,402)</b>	<b>226,033</b>	<b>44,019</b>	<b>488,208</b>	<b>0</b>	<b>0</b>	<b>488,208</b>
<b>Costs with Carry-Forward</b>	<b>663,940</b>	<b>1,228,279</b>	<b>160,157</b>	<b>638,242</b>	<b>1,102,598</b>	<b>3,793,216</b>	<b>6,519,200</b>	<b>1,813,124</b>	<b>12,125,540</b>
<b>Adjustments</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>Proposed Costs</b>	<b>663,940</b>	<b>1,228,279</b>	<b>160,157</b>	<b>638,242</b>	<b>1,102,598</b>	<b>3,793,216</b>	<b>6,519,200</b>	<b>1,813,124</b>	<b>12,125,540</b>

Note: This is a sample of what a summary schedule might look like, not all central service departments or receiving departments are listed.

## **Section 1300: Cost Plan Approval Process**

The SCO has established a formal procedure for consistent review of countywide cost allocation plans that includes a combination of both desk and field reviews.

### **Section 1305: Supplemental Information Checklist**

A desk review of a county's cost allocation plan will not begin until a supplemental checklist (see Exhibit 1303) and all other required supporting information have been received by the County Cost Plans Unit. In order to make sure that the cost plan was prepared adequately and that all necessary supporting documents were submitted, this checklist must be completed and certified by the appropriate individuals. Any items in the checklist that are answered in the negative must be fully explained in the "Comments" section found at the end of the checklist.

### **Section 1310: Elements of the Desk Review**

Cost plans are received by the SCO and assigned to an analyst, who is responsible for the review, negotiation, and approval of the cost plan. Before any type of approval is issued, the cost plan is subjected to a comprehensive desk review. The assigned analyst performs a preliminary examination of each plan to ensure that:

- The plan was received in accordance with the submission deadline.
- All information listed on the Supplemental Information Checklist has been submitted (see Exhibit 1303).

The desk review process includes, but is not limited to, the following processes:

- Cost plan narratives are reviewed to ensure that they fully explain the development of each allowable cost (see Section 2160 Narratives).
- The cost plan is compared to the financial statements containing the actual costs upon which it was based. If the costs shown in the cost plan do not agree with the financial statements, the county must prepare and include a reconciliation schedule explaining any differences.
- The allocation methodology and statistics are examined to ensure that proper cost principles and procedures, as outlined in 2 CFR Part 200, ASMB C-10, and this handbook, have been adhered to.
- All revenues and other financing sources (e.g., interfund and intrafund) generated by or imputed to each central support department are reviewed to ensure that they have been properly applied to the appropriate expenditures. Financing resources that are not identifiable to a particular operating department are applied before allocation (off-the-top). If identifiable to one or more specific departments, they are applied as a part of the allocation process (direct billed).

Further analysis will be undertaken to ensure that:

- Each schedule, and the cost plan in its entirety, are mathematically correct;
- Inter-schedule postings are properly summarized;
- Carry-forward has been correctly computed (See Section 1385, Fixed (Estimated) with Carry-Forward); and
- The cost summary/exhibit was properly prepared and is presentable for distribution and use.

### **Section 1315: Field Review**

Routinely, or when deemed necessary as a result of the desk review process, the analyst will contact the appropriate county official(s) in order to schedule and perform a “field review.” The purpose of this type of review is to:

- Verify the information supporting the cost plan and resolve any questions that were noted in the desk review process;
- Examine financial and statistical information and other supporting documentation used to prepare the cost plan in order to verify that the information is complete and accurate and that the cost plan, as presented, is both reasonable and equitable;
- Review billing methods; and
- Note and record any significant changes to the county government and its accounting procedures.

### **Section 1320: Review Letter/Field Review Report**

After completing a desk review or a combination of a desk and field review, the analyst summarizes, in a review letter or a review report to the county, all review findings and any questions that have not been resolved. If only a desk review was performed, a review letter will be used. If a desk and field review was performed, a review report is sent to the appropriate county official(s) requesting a response to the review report findings.

Following are situations or examples of findings that are typically encountered during a desk and field review:

- If an item of cost is not questioned, it will be considered, based on the information available to the analyst, acceptable as currently presented;
- Financial costs and/or statistical data that do not accurately reflect the county’s actual experience may be identified. If the analyst believes that the resulting allocations are not materially inaccurate enough to warrant a revision of the cost plan, these items will be

described and the county advised that any associated procedural deficiencies must be corrected in future years; and

- Any financial costs and/or statistical data that are materially inaccurate enough to warrant a revision of the cost plan will be described.

Based on the desk and/or field review, the county's review letter or review will contain one of the following overall decisions:

- The cost plan is acceptable as submitted and approved as prepared;
- The cost plan is acceptable as submitted and approved, with non-material findings noted (a response to the findings is normally required); or
- The cost plan is not acceptable as submitted because of specifically identified deficiencies. The cost plan must be revised to correct the noted deficient areas before any type of approval will be issued.

### **Section 1325: Timetable for Response to Field Review Report**

Should the SCO determine that cost plan revisions or modifications to county practices and/or procedures are required, the county must respond to the findings in the field review report within the following timelines:

1. California counties must respond to the SCO field review report within 30 days of the report date. The response must address each finding and recommendation with a proposed solution to correct any identified deficiencies.

If it is determined that the County's proposed solutions are acceptable, the SCO will notify the county of its decision by letter. Furthermore, the county must submit a revised (corrected) cost plan within 30 days of this notification. When the revised cost plan is received, it will be reviewed to ensure that all revisions have been included and that it meets the approval requirements.

2. If a county does not respond to the field review report within 30 days of receipt, the SCO will send the county a reminder letter. The county must respond to the findings and recommendations within 15 days from the date of this reminder letter.

Should a county fail to respond by the end of the 15-day period, the SCO may deem it necessary that any approval of the cost plan currently in effect may also be rescinded. The SCO enforces these policies to ensure that the approval process is kept within a 90-day period from the date the field review report was issued.

### **Section 1330: Objection Procedures**

Objection procedures provide counties with an opportunity to challenge the findings and recommendations developed by cost plan reviewers. Objection to any findings or recommendations should be included in the county's initial response to the SCO field review

report. The objection should be in one of the following formats, specifically addressing each finding and associated recommendation to which the county has objected:

- The finding is substantially correct, but the county proposes to implement a solution that is different than the associated recommendation. The county must include the specific reasons for its proposed solution;
- The finding is substantially correct, but the county feels that any required revisions will have an immaterial effect on grant programs. Future cost plans will incorporate the associated recommendation(s); or
- The finding is not correct, and the county disputes the finding(s) and the associated recommendation(s).

In the case of the above situations, the county must provide the SCO with documents, schedules, and other information substantiating the validity and adequacy of the response.

### **Section 1335: The Determination (Resolution/Conclusion)**

Upon receipt of the county's response to a field review report, the SCO will begin a review and determination process. The response to each finding and recommendation will be evaluated to determine appropriateness of all cost plan policies and interpretations that were in effect during the fiscal years that the cost plans were in use. All supporting documentation will be reviewed to substantiate the county's non-approval.

One of the following decisions will be made for each item objected to in the county's response:

- The reviewer's finding and recommendation are sustained. The county must implement the recommendation as it is stated;
- The reviewer's finding is sustained. However, because any revisions to the cost plan would be immaterial, no adjustments will be required on the part of the county. The county must follow the procedures identified in the recommendation in the preparation of future cost plans; or
- The county's non-approval is sustained. The finding and associated recommendation are removed.

The types of decisions cited above are representative of the majority of decisions prepared by the SCO but are not all-inclusive.

If a determination by the SCO requires adjustments to any cost plan data, it will include a statement requesting the county to revise the cost plan in accordance with the SCO determination. Any corrections resulting from required plan revisions must be identified in the cost summary/exhibit of the revised cost plan submitted to the SCO.

Copies of the determination, review, and protest, will be provided to the county and to HHS.

### **Section 1340: Adjustments to Prior-Year Cost Plans**

All records that support cost plans are subject to audit and review must be retained until the audit or review is resolved. The right of the SCO to access any records is not limited to any specific retention period (see Section 2180, Record Retention Requirements). The SCO will not require any adjustments to plans already formally approved, unless:

- The county provided information that was used as a basis for preparation of all or part of a formalized cost plan that was subsequently found to be materially incomplete or inaccurate and resulted in a substantial inequity to either central support or operating departments;
- Changes are made to the organizational structure or accounting methods of the county that materially affect the amount of reimbursement resulting from the use of amounts approved in the cost plan; or
- The approved plan was not accurately implemented or a duplication of cost resulted from the use of the plan.

### **Section 1345: The Appeal Process**

The appeal process allows a county to request reconsideration of any review findings or recommendations upheld by the SCO. Upon receipt of a determination package, the county should review the decision(s) of the SCO. If the county disagrees with any part of the determination package, a formal request for review of the item(s) in question may be made to HHS. Counties have 60 days from the date of a determination cover letter to submit a formal appeal to:

Department of Health and Human Services  
Cost Allocation Services  
90 – 7<sup>th</sup> Street, Suite 4-600  
San Francisco, CA 94103

The SCO will make every effort to resolve disagreements between itself and counties in a fair and equitable manner. Counties should not overburden the appeal process by sending frivolous protests to HHS.

### **Section 1350: Cost Plan Adjustments**

After a review has been completed, adjustments may be required to correct cost plan(s) that have been reviewed. The required adjustments must be identified as “prior year adjustments” in the next cost plan submitted to the SCO for review and approval.

### **Section 1355: Types of Approvals**

The SCO currently issues formal and provisional cost plan approvals. Each type of approval is distributed to all appropriate state and federal grantor agencies, as well as to the county.

### **Section 1360: Formal Approval**

An approval consists of a formal negotiation agreement signed by the SCO and an authorized representative of the county. Section I of the Negotiation Agreement signifies that the county has followed all applicable federal and state costing principles in preparing its cost allocation plan. Additionally, the cost summary/exhibit attached to the approval reflects the actual costs allocated to operating departments.

All federal grantor agencies accept and honor this formal negotiation agreement when determining allowable costs for reimbursing the county. State grantor agencies that distribute federal flow-through funds will, in the absence of a specific agreement to the contrary, also accept and honor this formal negotiation agreement when determining allowable costs for reimbursing a county. Both indirect central services costs and direct charges associated with grants and contracts will be accepted.

### **Section 1365: Reliance upon Formal Approval**

Formal cost plan approval signifies that both the SCO and the county have accepted the plan costs as final costs for the applicable fiscal year. Both parties are equally bound by the negotiation agreement and are entitled to rely on the agreement, subject to its terms and conditions, including any limitations recorded in the plan or the plan's negotiation agreement. The plan's approved actual costs are considered to be closed and not subject to any adjustments, either retroactively or by carry-forward to a future year, unless they violate a condition stated in Section 1340 Adjustments to Prior-Year Cost Plans.

### **Section 1370: Changes to Formally Approved Cost Plans**

Changes to the costs presented in formally approved cost plans will be allowed only when a subsequent examination or audit reveals inequities or factual errors and the SCO determines the amounts involved to be material.

Approved costs are considered to be closed. No changes will be allowed unless a compelling reason exists either in law, statute, or regulation that requires the reopening of negotiations.

### **Section 1375: Provisional Approval**

Only the SCO representative has authority to sign a provisional agreement. A provisional approval is subject to later revision pending a subsequent review and is otherwise identical in all other respects to a formal approval. It is distributed to, and must be used by, all federal and state grantor agencies in reimbursing the county for the indirect costs associated with its federally funded grants and contracts.

### **Section 1380: Approval Methodology**

All proposed countywide cost allocation plans will be reviewed, negotiated, and approved by the SCO on a timely basis. Plans will be reviewed within six months of receipt. The SCO will notify the county of any additional information and/or documentation needed or if changes are required in the county's prepared cost plan. After an agreement with the county has been reached, the agreement will be accepted and used by all county agencies unless prohibited or limited by statute. If a federal funding agency believes that special operating factors affecting its



awards necessitate special consideration, then the funding agency must, prior to the time the cost plans are negotiated, notify the SCO.

### **Section 1385: Fixed (Estimated) with Carry-Forward**

Allocated central service costs are usually negotiated and approved for the following fiscal year on a “fixed (estimated) with carry-forward” basis. Under this procedure, the fixed (estimated) amounts for the future year covered by the agreement are not subject to adjustments for that year. However, when the actual costs of the year involved become known, the differences between the fixed (estimated) amounts previously approved and the actual costs will be carried forward and used as an adjustment to the fixed (estimated) amounts established for a later year. This “carry-forward” procedure applies to all central services whose costs were fixed (estimated) in the approved cost plan. A carry-forward adjustment is not permitted for a central service or operating activity that was not included in the approved cost plan or for unallowable costs. When unallowable costs have been claimed and reimbursed, they will be refunded to the program that reimbursed the unallowable cost using one of the following methods:

- A cash refund;
- An offset to a subsequent claim; or
- Credits to the amounts charged to individual awards.

### **Section 1390: Indirect Cost Claiming: Amounts vs. Rates**

The cost summaries/exhibits attached to formal and provisional negotiation agreements contain only the unbilled amount of services and overhead pertaining to the operating departments, carry-forward, and other required adjustments. The total amounts identified to each department are not converted to departmental “indirect cost rates” and the SCO will not approve any cost summary/exhibit containing such rates. If the county wishes to use such rates in its claiming process, it must prepare departmental indirect cost rate proposals using the amounts identified on the cost summary/exhibit and submit its proposals to the appropriate grantor agencies. Major grant programs in California have established their indirect cost claiming formats to recognize a dollar amount of indirect cost as identified on the cost summary/exhibit, as opposed to recognizing a rate that is applied to some appropriate base.

### **Section 1395: Examples of Approvals**

Examples of formal and provisional negotiation agreements can be found in Exhibits 1301 and 1302. These agreements share the following common elements:

#### **Heading and Introductory Paragraphs**

The general heading identifies the type of approval, the date of issue by the SCO, and the county to which it is issued. A formal negotiation agreement may be distinguished from a provisional agreement by its heading and by the inclusion of a signature block signed by both a county and a SCO representative.

The paragraph immediately following the heading identifies the fiscal years covered by the agreement, and includes a statement to the effect that the SCO either formally or provisionally approves, pursuant to 2 CFR Part 200, a countywide cost allocation plan for use as an actual plan for a given fiscal year. A provisional negotiation agreement will state that there is a possibility of a future field review before the associated cost plan can be granted formal approval.

The second paragraph contains a statement concerning data processing system costs. General data processing system costs that have a countywide application are considered allowable for grant reimbursement purposes. However, those costs that are applicable specifically to a grantee department may require the prior approval of the grantor agency before being considered eligible for reimbursement.

### **Section I - Costs Distributed Through Countywide Cost Allocations**

Section I of both a formal and provisional approval pertains to the cost summary/exhibit. The cost summary/exhibit is attached to, and distributed with, the approval to all concerned state and federal agencies. The cost summary/exhibit is a compilation of all unbilled central and indirect overhead costs allocated to the operating departments. These costs are approved as actual costs of a given fiscal year and are normally used as the estimated costs for the fiscal year indicated. The amounts identified on the cost summary/exhibit are to be included, along with the other costs of a department, for further allocation to the grants and contracts being performed by that department on a reimbursable basis.

Any differences between the amount cited on the cost summary/exhibit and the actual costs of the fiscal year for which the summary serves as an estimate will be considered in a subsequent negotiation agreement.

### **Section II - Costs Distributed Through Billing or Transfer Mechanisms**

Section II of either a formal or provisional negotiation agreement pertains to central support or indirect overhead costs that are distributed through billing mechanisms. The cost centers identified in this section have been approved to charge for their services during the fiscal year. Billing mechanisms and adjustment procedures have been approved in accordance with the proper costing principles.

Any variances resulting from differences between billed costs and the actual experience of a particular accounting period will be considered in a subsequent approval.

### **Section III - Conditions**

Section III of either a formal or a provisional negotiation agreement identifies the limitations and conditions under which the approval is accepted for use for grant reimbursement purposes. Any conditions included under *Section III, F. Special Remarks*

are mandatory and must be implemented in the specified cost plan(s) by all agencies to which they apply.

#### **Section IV - Acceptance**

Section IV of the formal approval constitutes the acceptance of the approval by the county and the SCO. Formal negotiation agreements will be considered approved when the agreement is signed by both the chief accounting officer of the county and an official designated by the SCO. Provisional negotiation agreements are signed only by an official designated by the SCO.

This section also identifies the SCO cost plan analyst who negotiated the agreement with the county.

**Exhibit 1301**



*California State Controller*

**Negotiation Agreement  
Countywide Cost Allocation Plan**

County of \_\_\_\_\_  
\_\_\_\_\_, California

**Date:**  
**Filing Ref:**

Pursuant to Federal Office of Management and Budget (OMB) Circular 2 CFR Part 200, the State Controller's Office formally approves the Countywide Cost Allocation Plan as described in Section I for use in the \_\_\_\_\_ fiscal year. This approval is subject to the conditions contained in Section III.

Departmental indirect cost proposals should clearly identify those costs that have been distributed through Sections I and II of this agreement in accordance with the guidelines of the responsible grantor agency for that department. Further, data processing systems may be subject to grantor agency approval prior to the reimbursement of certain costs allocated, billed, or cost applied from the Data Processing Department.

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**SECTION I: COSTS DISTRIBUTED THROUGH COUNTYWIDE COST ALLOCATIONS**

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The indirect overhead and support service costs listed in **Cost Summary/Exhibit** (attached) are formally approved as actual costs for the \_\_\_\_\_ fiscal year and as estimated costs for the \_\_\_\_\_ fiscal year on a "fixed with carry-forward" basis. These costs may be included as part of the costs of the county departments indicated effective \_\_\_\_\_, for further allocation to federal grants and contracts performed by the respective county departments.

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**SECTION II: COSTS DISTRIBUTED THROUGH BILLING OR COST  
TRANSFER MECHANISMS**

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- |                             |     |
|-----------------------------|-----|
| 1. Employee Fringe Benefits | 12. |
| 2.                          | 13. |
| 3.                          | 14. |
| 4.                          | 15. |
| 5.                          | 16. |
| 6.                          | 17. |
| 7.                          | 18. |
| 8.                          | 19. |
| 9.                          | 20. |
| 10.                         | 21. |
| 11.                         | 22. |

In addition to Section I, which provides for services furnished but not billed, the services listed above are furnished and billed to state/local departments and agencies.

Direct charges from the above centers should be billed or cost applied in accordance with the procedures established by the county as described in its Countywide Cost Allocation Plan and may be included as part of the costs of the county departments indicated in Section I.

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**SECTION III: CONDITIONS**

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**A. LIMITATIONS:** Use of the amounts contained in this Negotiation Agreement are subject to any statutory or administrative limitations and, when ultimately allocated to individual grants or contracts through the indirect cost proposals of each county department, are applicable only to the extent that funds are available. Acceptance of the amounts agreed to herein is predicated on the conditions: (1) that no costs other than those incurred by the county were included for distribution in its Countywide Cost Allocation Plan as finally accepted, and that such costs are legal obligations of the county and allowable under the governing cost principles, (2) that similar types of costs have been accorded consistent accounting treatment, and (3) that the information provided by the county that was used as the basis for acceptance of the amounts agreed to herein is not subsequently found to be materially incomplete or inaccurate.

**B. CHANGES:** Fixed amounts contained in this Negotiation Agreement are based on the organizational structure and the accounting system in effect at the time the proposal was submitted. Significant changes in the organizational structure or changes in the method of accounting for costs that materially affect the amount of reimbursement resulting from use of the amounts in this Negotiation Agreement will require prior approval of the authorized representative of the responsible negotiation agency. Failure to obtain such approval may result in subsequent audit disallowances.

**C. FIXED AMOUNTS:** The fixed amounts contained in Section I of this negotiation agreement are based on an estimate of the costs that will be incurred during the period to which the amounts apply. When the actual costs for this period are determined, any differences between the fixed costs used as an estimate and the actual costs will be considered in a subsequent agreement.

**D. BILLED COSTS:** Charges for the services cited in Section II will be billed or cost applied in accordance with the procedures established by the county and recorded on the books of the cost center providing the service. Such charges will be based on the actual allowable costs, as defined by OMB Circular 2 CFR 200, incurred by the cost center responsible for providing the service. Any differences between the billed allowable costs and the actual allowable costs for a particular accounting period will be considered in a subsequent agreement.

**E. NOTIFICATION TO STATE AND FEDERAL AGENCIES:** Copies of this document will be provided to other state and federal agencies as a means of notifying them of this approval.

**F. SPECIAL REMARKS:**

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**SECTION IV: ACCEPTANCE**

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COUNTY OF \_\_\_\_\_

\_\_\_\_\_  
**CALIFORNIA STATE CONTROLLER**

BY \_\_\_\_\_

BY \_\_\_\_\_

\_\_\_\_\_  
**Name**

**Local Government Programs and Services  
Division**

\_\_\_\_\_  
**Title**

\_\_\_\_\_  
**Date**

\_\_\_\_\_  
**Date**

**Negotiated by  
Telephone (916) XXX-XXXX**

cc: State and Federal Agencies

Attachment

Exhibit 1302



California State Controller

**Provisional Negotiation Agreement  
Countywide Cost Allocation Plan**

County of \_\_\_\_\_  
\_\_\_\_\_, California

Date:  
Filing Ref:

Pursuant to federal Office of Management and Budget (OMB) Circular 2 CFR Part 200, the State Controller's Office provisionally approves the Countywide Cost Allocation Plan as described in Section I for use in the \_\_\_\_\_ fiscal year. This provisional approval is subject to the conditions contained in Section III. A field examination may be necessary before the plan can be granted formal approval.

Departmental indirect cost proposals should clearly identify those costs that have been distributed through Sections I and II of this agreement in accordance with the guidelines of the responsible grantor agency for that department. Further, data processing systems may be subject to grantor agency approval prior to the reimbursement of certain costs allocated, billed, or cost applied from the Data Processing Department.

---

**SECTION I: COSTS DISTRIBUTED THROUGH COUNTYWIDE COST  
ALLOCATIONS**

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The indirect overhead and support service costs listed in the **Cost Summary/Exhibit** (attached) are provisionally approved as actual costs for the \_\_\_\_\_ fiscal year and as estimated costs for the \_\_\_\_\_ fiscal year on a "fixed with carry-forward" basis. These costs may be included as part of the costs of the county departments indicated effective \_\_\_\_\_ for further allocation to federal grants and contracts performed by the respective county departments.

---

**SECTION II: COSTS DISTRIBUTED THROUGH BILLING OR COST TRANSFER MECHANISMS**

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- |                             |     |
|-----------------------------|-----|
| 1. Employee Fringe Benefits | 6.  |
| 2.                          | 7.  |
| 3.                          | 8.  |
| 4.                          | 9.  |
| 5.                          | 10. |

In addition to Section I, the services listed above are furnished and billed to state/local departments and agencies.

Direct charges from the above centers should be billed or cost applied in accordance with the procedures established by the county as described in its Countywide Cost Allocation Plan and may be included as part of the costs of the county departments indicated in Section I.

---

**SECTION III: CONDITIONS**

---

**A. LIMITATIONS:** Use of the amounts contained in this Provisional Approval are subject to any statutory or administrative limitations and, when ultimately allocated to individual grants or contracts through the indirect cost proposals of each county department, are applicable only to the extent that funds are available. Acceptance of the amounts agreed to herein is predicated on the conditions: (1) that no costs other than those incurred by the county were included for distribution in its Countywide Cost Allocation Plan as finally accepted, and that such costs are legal obligations of the county and allowable under the governing cost principles; (2) that similar types of costs have been accorded consistent accounting treatment; and (3) that the information provided by the county that was used as the basis for acceptance of the amounts agreed to herein is not subsequently found to be materially incomplete or inaccurate.

**B. CHANGES:** Fixed amounts contained in this Provisional Approval are based on the organizational structure and the accounting system in effect at the time the proposal was submitted. Significant changes in the organizational structure or changes in the method of accounting for costs that materially affect the amount of reimbursement resulting from use of the amounts in this Provisional Approval will require prior approval of the authorized representative of the responsible negotiation agency. Failure to obtain such approval may result in subsequent audit disallowances.

**C. FIXED AMOUNTS:** The fixed amounts contained in Section I of this Provisional Approval are based on an estimate of the costs that will be incurred during the period to which the amounts apply. When the actual costs for this period are determined, any differences between the fixed costs used as an estimate and the actual costs will be considered in a subsequent agreement.



**D. BILLED COSTS:** Charges for the services cited in Section II will be billed or cost applied in accordance with the procedures established by the county and recorded on the books of the cost center providing the service. Such charges will be based on the actual allowable costs, as defined by OMB Circular 2 CFR 200, incurred by the cost center responsible for providing the service. Any differences between the billed allowable costs and the actual allowable costs for a particular accounting period will be considered in a subsequent agreement.

**E. NOTIFICATION TO STATE AND FEDERAL AGENCIES:** Copies of this document will be provided to other state and federal agencies as a means of notifying them of this approval.

**F. SPECIAL REMARKS:**

**CALIFORNIA STATE CONTROLLER**

**BY** \_\_\_\_\_

**Local Government Programs and Services Division**

\_\_\_\_\_  
**Date**

## **Exhibit 1303**

Please visit the “Forms” section of the County Cost Plans Unit website for the latest version of the Supplemental Information Checklist (Exhibit 1303):

[https://sco.ca.gov/ard\\_county\\_cost\\_allocation.html](https://sco.ca.gov/ard_county_cost_allocation.html)

## **Exhibit 1304**

Please visit the “Forms” section of the County Cost Plans Unit website for the latest version of the Pension Obligation Bond Certification (Exhibit 1304):

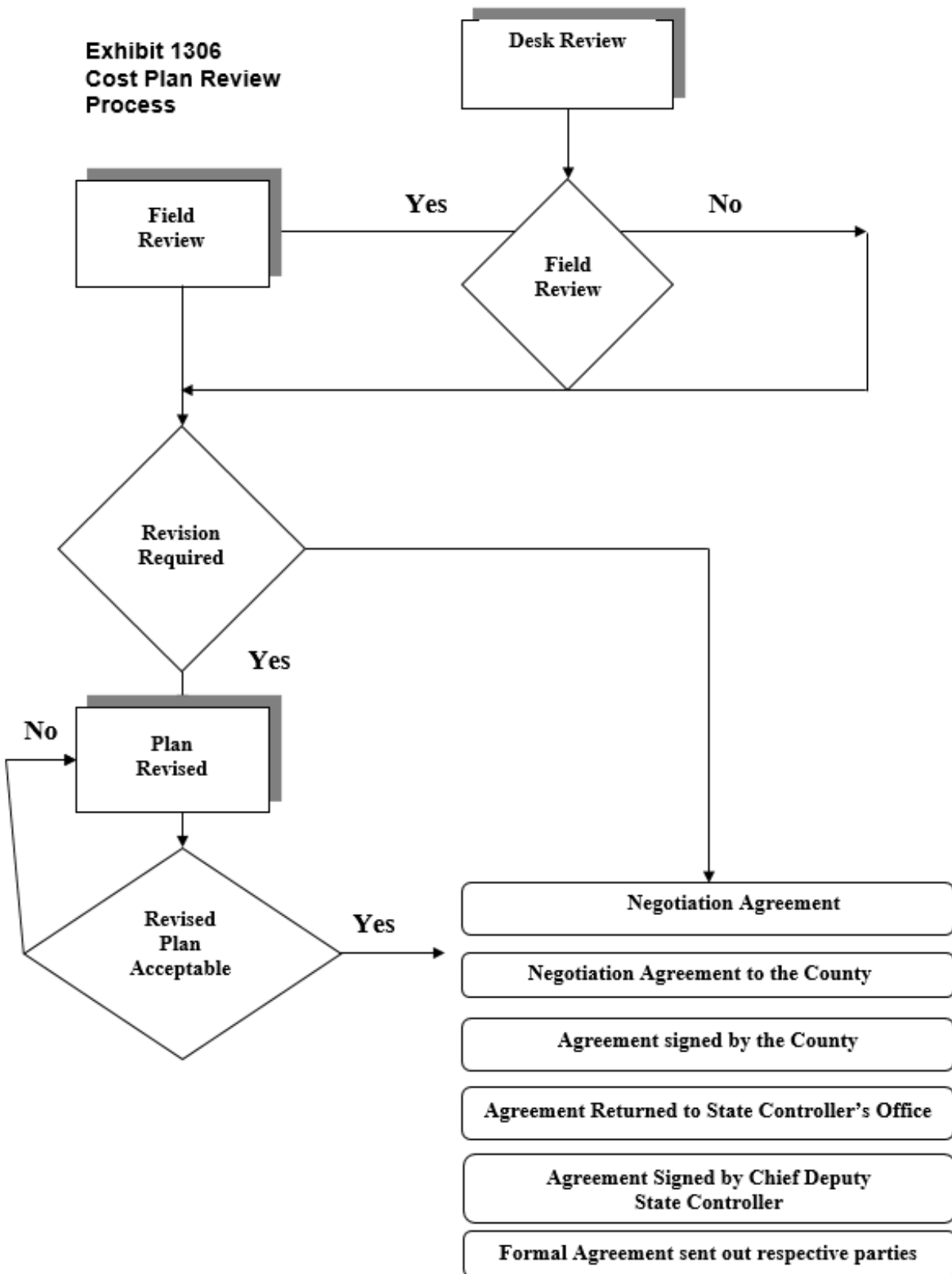
[https://sco.ca.gov/ard\\_county\\_cost\\_allocation.html](https://sco.ca.gov/ard_county_cost_allocation.html)

## **Exhibit 1305**

Please visit the “Forms” section of the County Cost Plans Unit website for the latest version of the Administrative Expense Claims Certification (Exhibit 1305):

[https://sco.ca.gov/ard\\_county\\_cost\\_allocation.html](https://sco.ca.gov/ard_county_cost_allocation.html)

**Exhibit 1306  
Cost Plan Review  
Process**



## **Section 1400: County Cost Plan Preparation**

Two major factors should be considered when preparing a cost plan. First, because the accuracy and completeness of the cost allocations must be maximized, the individual who is responsible for preparing the cost plan should be familiar with the overall operations of the county and with how the county's financial data is recorded. Second, the county's cost plan coordinator should be an individual familiar with all grant programs in order for the county to maximize reimbursements for indirect costs.

### **Section 1410: Cost Plan Coordinator**

The cost plan coordinator should be an individual who is familiar with the organizational structure and fiscal operations of all county departments. The total value of indirect services received by county operating departments from central support departments is identified through the cost plan. These values must be offset by any direct charges imposed during the year. The completeness and accuracy of the cost plan is essential to properly determine the costs of central services. A complete and accurate cost plan is essential to budget preparation and ensures that the maximum valid reimbursable indirect costs are claimed from the agencies that administer the county's grant programs. Experience has shown that the best person to coordinate the recovery of indirect costs is usually a member of the county's accounting department or an employee of a department that deals with the overall fiscal operations of the county.

### **Section 1420: Cost Plan Certification**

A cost plan submitted to the SCO must be accompanied by a certification that provides the information specified in 2 CFR Part 200 Appendix V, Section E.4. The official responsible for the county's overall fiscal operations must sign this certification. In California, this individual is the chief accounting officer for the county, normally the county auditor (or auditor-controller), or an authorized deputy. The cost plan cannot be certified by the cost plan coordinator unless that individual is also the county chief accounting officer or that officer's authorized deputy.

### **Section 1430: Grants Management Coordinator**

After the SCO has approved a county's cost plan, copies of the approval and the attached cost summary/exhibit are mailed to the county, state, and federal agencies. The county's grants management coordinator is responsible for instructing these agencies on the significance and proper use of the cost plan. In many cases, the county's grants management coordinator also serves as the cost plan coordinator.

County departments that receive reimbursements for their programs, as well as any departments that charge non-county agencies for their services, will find cost plan allocations to be especially useful. Cost plans allow a county to maximize the recovery of indirect costs recorded in its cost plan's summary schedules/exhibits.

The grants management coordinator should interview all county department heads to determine if any of their programs are eligible for reimbursement. After these programs have been identified, each individual grant or contract should be analyzed to determine which indirect costs are reimbursable. To aid the grants management coordinator in this task, the Grants Management

Advisory Service in Washington, DC, publishes the [Federal Grant Management Handbook](#). This publication outlines the entire grant management and accounting process, identifies those federal departments having grant programs, and provides a monthly summary of the latest current developments affecting federal grants.

Once reimbursable programs are identified, the grants management coordinator should monitor the reimbursement process to ensure that maximum reimbursements have been received by the county for all program costs, including indirect overhead. Additionally, any departments that charge outside agencies for their services should be monitored to ensure that the billing structures used recover all applicable costs, including indirect overhead.

#### **Section 1440: Grantee Departments' use of Cost Plan**

County departments receiving reimbursement for costs through federal and state grants should use the county's approved cost plan in the grant claiming process. Grant claims should be prepared and submitted in accordance with the applicable regulations and procedures established by the appropriate grantor agency. They should recognize and include the amounts identified to the respective departments on the approved cost summary/exhibit.

Unless there is a specific agreement to the contrary, all federal grantor agencies and state agencies with federal flow-through funds must accept the countywide cost allocation plan as approved by the SCO and must reimburse indirect costs incurred by county grantee departments in accordance with the approved cost summary/exhibit.

Some grant programs funded solely by the State of California do not entirely recognize the amounts approved on the cost summary/exhibit.

#### **Section 1450: Indirect Costs used as Matching Share**

Some federal grants do not provide funds for the reimbursement of indirect costs. However, if these same grants require the county to "match" a specified portion of the overall costs of the grant program, then the indirect overhead costs identified in the cost plan can be included in the county's matching share.

#### **Section 1460: Non-Grantee Departments' use of Cost Plan**

Non-grantee departments charging for their services can use the cost plan in determining their billing rate structures. If a department charges the public a fee for a service it provides, then the board of supervisors should be aware of the total cost of providing those services, including all applicable indirect costs. This will allow the supervisors to establish fees at the appropriate level to recover the true costs associated with the services provided. Even if the department is not charging a fee for the service, this concept can be employed as a management tool in identifying countywide overhead costs to all applicable departments. Non-grantee departments should note the cost recovery limits set by 2 CFR Part 200 and, if necessary, adjust their costs to recover as much of the total cost of doing business as possible.

#### **Section 1470: Full Costing Plan**

Although the cost plan as approved by the SCO includes only those costs considered reimbursable for federal and state purposes under the current cost principles, it is the best tool available to accomplish the task described above. A county could prepare a “full costing plan” to identify all county overhead costs to the appropriate departments, including those costs that are currently considered unallowable (e.g., general government costs). If a method can be devised in which the “cost reimbursement plan” and the “full costing plan” can be prepared simultaneously, while still allowing the identification and approval of only the portion pertaining to grant reimbursements, then the entire package could be submitted to the SCO for approval. Otherwise, the “full costing plan” should be prepared separately and retained by the county for management purposes.



## **Exhibit 1401**

Please visit the “Forms” section of the County Cost Plans Unit website for the latest version of the Certificate of Cost Allocation Plan (Exhibit 1401):

[https://sco.ca.gov/ard\\_county\\_cost\\_allocation.html](https://sco.ca.gov/ard_county_cost_allocation.html)

## **Section 1500: Audits**

Authority to audit county cost plans usually lies with the federal agency having cognizance for the approval of these plans. In California, HHS' designee, the SCO, is responsible for the audit and approval of all 58 countywide cost allocation plans. The audits of cost plans will be performed under the policies and procedures set forth in 2 CFR Part 200, ASMB C-10, this handbook, and any other guidance issued by HHS and the SCO in effect during the years the cost plans under audit were in use.

If any county audit includes findings or recommendations that address or apply to the county's cost plan, a copy of the audit report and the county's reply to the report must be provided to the SCO for review and comment. The SCO must also be advised if any prior-year cost plans considered to be outside of the retention period policy will require adjustments.

### **Section 1510: Audit of Formally Approved Plans**

The benefits of an audit are maximized if the audit recommendations are available before a cost plan is granted formal approval. However, situations may arise in which audits are performed on a "post-audit" (audit of an approved plan) basis. If a cost plan that has already been granted a formal approval is audited, no adjustments will be made to the plan except in the unusual circumstances outlined in Section 1370 Changes to Formally Approved Cost Plans, of this handbook, or when both parties agree to reopen negotiations. Post-audits of formally approved plans are generally useful only to the extent that they result in the implementation of improved methodology for future plans.

### **Section 1520: The Protest**

The protest constitutes the county's first opportunity to refute the exceptions taken by cost plan auditors. Counties must respond, in the format prescribed by the agency that conducted the audit, to all audit findings for all fiscal years covered within the scope of the audit. It is the responsibility of the county that has been audited to provide the SCO with all audit information, including audit protests, that pertains to its cost plans or to its cost plan procedures.

### **Section 1530: The Determination**

When a county's protest is received, the SCO begins a determination process. Each cost plan finding and/or exception is studied to determine how appropriate the corresponding recommendation is in light of the policies and interpretations of 2 CFR Part 200, ASMB C-10, and this handbook that were in effect during the fiscal years the plans under audit were in use. The county's response and any supporting documentation are reviewed to substantiate issues of immateriality or incorrectness. A determination is then developed for each item in the format specified in Section 1325 Timetable for Response to Field Review Report, of this handbook. Counties may appeal any review findings or recommendations upheld by the SCO, in accordance with Section 1345 The Appeal Process, of this handbook.

Should the determination by the SCO involve adjustments to cost plan data, the determination will contain a concluding statement to the effect that the county must revise the actual costs of the fiscal years under audit in accordance with the previously discussed determinations. Any

corrections resulting from required plan revisions should be identified on the cost summary/exhibit of the next cost plan submitted to the SCO.

Copies of the determination packet containing copies of the audit, the protest, and the determination, will be distributed to the county, the audit agency, and HHS.

### **Section 1540: Program Audits**

In the course of their audits, program auditors may examine the charges to federal and state programs from the cost plan. The extent of their authority in reviewing these charges is limited to determining whether or not these indirect costs approved for use by the SCO were claimed properly by the grantee department. Inherent in this examination is the necessity for the program auditors to determine if any costs claimed directly by the grantee were also claimed as an indirect cost via the cost plan.

If a county receives a program audit report containing an exception that pertains to a claiming error, in most cases the cost plan will remain intact as approved. Any required adjustments will be made on the claims submitted to the grantor agency. If the same report contains an exception that pertains to the preparation of the cost plan, the SCO should be notified and will resolve the issue. Since more than one department or fiscal year may be affected, at no time should the county and the grantor agency or its auditors attempt to adjust any costs identified in the cost plan without first notifying the SCO and receiving its concurrence.

### **Section 1550: The Single Audit Act**

The Single Audit Act is intended to establish uniform requirements for audits of federal awards administered by non-federal entities. It is designed to promote the efficient and effective use of audit resources and to reduce the burdens on state and local governments, Indian tribes, and nonprofit organizations. The Single Audit Act ensures that federal departments and agencies, to the maximum extent practicable, rely upon and use audit work done pursuant to Chapter 75 of Title 31, United States Code, as amended. It also makes audit requirements uniform for all types of grantees and stipulates that government auditing standards are to be followed in all audits of state and local governments conducted in accordance with the Act. The cognizant agency for each audit is the federal agency designated to carry out single audit responsibilities. The oversight agency for each audit is the federal agency that provides the predominate amount of direct funding to a recipient not assigned a cognizant agency for audit purposes. When there is no direct funding, the federal agency providing the greatest amount of indirect funding is assigned oversight responsibilities.

Under the provisions of the Single Audit Act, all federal agencies may use the results of single audits as a base from which to perform grant and program-specific audit requirements.

## **Section 2100: Acceptable Cost Allocation Plans**

California recognizes and accepts two types of cost allocation plans. The first type of cost plan over which the SCO has cognizance identifies and distributes overhead and central service costs that have been incurred to provide services or benefits to all county departments. These identified costs are assigned to all county departments, whether or not they receive grants or perform contracts for the federal government or the State of California. This type of plan is commonly referred to as a “countywide cost allocation plan.”

The second type of plan, a “departmental indirect cost rate proposal,” has a narrower focus than the countywide cost allocation plan. Plans of this type are discussed in 2 CFR Part 200, Appendix VII. Departmental indirect cost rate proposals identify and distribute the overhead and administrative costs of an operating department, including costs assigned to the department under the countywide cost plan, to programs administered by the department. This type of plan is not included as part of the countywide cost allocation plan. 2 CFR Part 200, Appendix VII, Section D, states that all departments or agencies of the governmental unit wishing to claim indirect costs under federal awards must prepare an indirect cost rate proposal and related documentation to support those costs. A governmental department or agency unit that receives more than \$35 million in direct federal funding must submit its indirect cost rate proposal to its cognizant agency for indirect costs (the federal agency providing that local government department with the most direct Federal funding). Other governmental departments or agencies receiving less than \$35 million in direct federal funding must develop an indirect cost proposal and maintain the proposal and related supporting documentation for audit. These government departments or agencies receiving less than \$35 million in direct federal funding are not required to submit their indirect cost rate proposals unless they are specifically requested to do so by the cognizant agency for indirect costs.

The SCO approves countywide cost allocation plans only as a method of assigning indirect costs for grant reimbursement purposes; it has no cognizance over departmental indirect cost proposals.

### **Section 2110: Claiming Reimbursement**

Unless there is a specific formal agreement between a county unit and a grant agency, the only method by which California counties may claim reimbursement for indirect and central service costs from grantor agencies is through a countywide cost allocation plan that has been approved by the SCO. Consequently, it is important that counties comply with the cost principles in 2 CFR Part 200, ASMB C-10, and this handbook. Failure to comply with these principles will, absent a specific agreement with a particular grantor agency, preclude a county from recovering costs that are legitimate charges to federal and state grants and contracts.

### **Section 2120: Acceptable Costs**

In order to be acceptable for reimbursement, costs presented in the countywide cost allocation plan must:

- Reflect the standards and policies contained in 2 CFR Part 200, ASMB C-10, and this handbook;

- Be necessary and reasonable for proper and efficient performance and administration of federal awards;
- Be allocable to federal awards under the provisions of 2 CFR Part 200;
- Be authorized or not prohibited under state or local law or regulations;
- Conform to any limitations or exclusions set forth in 2 CFR Part 200, federal laws, terms and conditions of the federal award, or other governing regulations as to types of 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, i.e., 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 and/or governmental generally accepted accounting principles, except as otherwise provided for in 2 CFR Part 200, ASMB C-10, or this handbook;
- 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 for by federal law or regulation;
- Be an amount net of all applicable credits and direct charges for services provided; and
- Be adequately documented.

### **Section 2130: Required Supporting Documentation**

All countywide cost allocation plans must include the certification referred to in Section 1420 Cost Plan Certification, of this handbook. An example of the required certification is provided in Exhibit 1401.

The audited official financial records of the county must support all cost plans. For California counties, the absolute minimum required documentation consists of a budget that contains the final revenue and expenditure amounts upon which the plan is based, plus the other documents required by the annual Supplemental Information Checklist (Exhibit 1303). If this budget is not already on file with the SCO when the cost plan is submitted, then a copy must be included with the cost plan. Any differences between cost plan line items and corresponding line items recorded in the budget must be fully reconciled in supporting documentation that accompanies the cost plan.

### **Section 2140: Cost Plan Development**

By using the following steps, counties can ensure complete documentation and proper organization in the development of their countywide cost allocation plans:

1. Prepare a county organization chart that clearly shows county operations, including central service activities. This chart must include county central service and operating units, and must depict their interrelationships. A copy of this chart must be initially provided to the SCO and an updated version forwarded when any significant organizational changes occur.
2. Interview department managers to determine those departments that provide services to other county departments or units. Any external overhead that is applicable to all departments should also be identified at this time.
3. Prepare narratives presenting the information described in Section 2160 for each external overhead or support service item. These narratives must be reviewed annually and revised as necessary to ensure that each cost plan includes all county organizational and procedural changes that may have occurred since the last cost plan filed with the SCO.
4. Distribute each central service department's expenditures to the department's cost pools, using percentages of effort applied or some other rational basis. Any revenues and transfer-ins that cannot be readily attributed to a specific department or agency must reduce cost pool expenditures.
5. Prepare detailed schedules for each cost pool, allocating the pooled expenditures to all benefitting departments and employing a rational allocation basis. Any amounts billed or intrafund transferred to the user departments must be deducted from the expenditures allocated to these departments.
6. Transfer the net allocations for each central service department's cost pools to a departmental summary cost schedule. The summary exhibit consolidates the department's net external overhead and support service costs allocated.
7. Carry the summary cost schedule information to the consolidated cost schedules. Use one schedule to compare the total of all costs allocated to each operating department with the corresponding costs used in the cost plan two years previously. Determine the plan "carry-forward" from these comparisons. Apply this "carry-forward" amount, and any other necessary adjustments, to the cost summaries allocated to each operating department to arrive at total allocated cost amounts.
8. Prepare a cost summary/exhibit. On this schedule, report and total the net amounts allotted to each operating department from each central service department's cost allocation summary. Add the computed "carry-forward" and any additional required adjustments to this total to arrive at the total adjusted indirect costs that may be claimed by each operating department. The totals on the cost summary/exhibit are the amounts that may be claimed from federal and state grant programs as reimbursement of indirect costs for each central service department.

### **Section 2150: Identifying Costs**

The best method available for identifying costs to the beneficiaries of the costs incurred is through a formal cost accounting system. If such a system does not exist, the only acceptable alternative is a cost allocation plan. When a cost allocation plan is employed to apportion indirect costs, the county should still track the actual costs incurred during each fiscal year. Doing so is necessary in order for all estimated indirect costs claimed by grant programs through the cost plan to be adjusted to actual costs by “carry-forward” in future accounting periods (see Section 2140, items 7 and 8 above).

### **Section 2160: Narrative**

Narratives are an integral part of the basis upon which the SCO approves cost plans. After a county has identified the overhead and central service programs that will be included in its cost plan, it must prepare an extensive narrative concerning each item. These narratives facilitate in-depth reviews of plans and enable the SCO to respond to questions from grantor agencies and cost plan auditors. The importance of accurate and complete narratives in the cost plan cannot be over-emphasized.

The narrative for each central support service must include:

- A description of the cost centers or functions within the service department and a concise summary of the extent to which each of these cost pools and/or functions provide services to other county departments;
- A description of the types of costs that are considered to be allowable, an explanation of why these costs are allowable, and a discussion of the method or methods used to separate allowable costs from those costs considered to be unallowable;
- A description of the allocation methods used to distribute costs in each cost pool and the source of the data used to distribute each cost pool’s assigned expenditures; and
- A description of the methodology used to identify any amounts billed to the user departments. The narrative for each schedule must include a specific identification of each revenue, interfund, and intrafund transfer received by the central support department whose expenditures are being allocated. If any of these resource inflows has not been used to reduce expenditure allocations, a complete explanation must be provided.

The narrative for each central service Internal Service Fund (ISF) must include:

- A complete, concise description of the ISF, including the types of costs incurred and the type and extent of all services provided;
- A description of the components and methodology used to develop the billing rates charged to the benefitting departments, including the treatment of the overhead and central support service costs that pertain to the ISF;

- A description of the accounting treatment used in clearing the over-or under-billings that may have resulted at fiscal year-end;
- A copy of the ISF's financial statements for the most recent fiscal year, including the balance sheet, statement of cash flows, and statement of revenues, expenses, and changes in net positions;
- If not provided in the audited financial statements, a complete analysis of the net positions and any transfers out for each ISF; and
- Any additional information addressing ISFs required in other sections of 2 CFR Part 200, ASMB C-10, or this handbook.

The description of the ISF and the methodology used to develop billing rates (see the second and third bullets above) need be submitted only when any information previously provided about that ISF changes. However, audited financial statements, analyses of net positions, and explanations of transfers out for each central-service ISF must be included with the cost plan each year.

Whenever a county's organizational structure changes from that depicted in the organizational chart on file with the SCO, cost plan narratives must be accompanied with an updated organizational chart. The organization chart should identify all county departments and illustrate their interrelationships, whether or not they are included as a service department in the cost plan.

### **Section 2170: Documentation for Reviews and/or Audits**

Each cost allocation plan should cover a single fiscal year and be based on the actual financial and statistical data for a given fiscal year. This data and the narratives discussed in the previous section constitute the documentation necessary to support the cost plan and to substantiate its adequacy and accuracy. Each cost schedule will include within the plan, or attached to the plan, a supplementary schedule that clearly reconciles the allocated costs, revenues, and transfers in to county financial statements, as well as a description of the allocation statistics used to distribute the costs to the benefitting departments. Counties must maintain all cost plan supporting data on file, as prescribed in Section 2180 Record Retention Requirements.

### **Section 2180: Record Retention Requirements**

2 CFR Part 200, Section 200.333, states:

Financial records, supporting documents, statistical records, and all other non-Federal entity records pertinent to a Federal award must be retained for a period of three years from the date of submission of the final expenditure report or, for Federal awards that are renewed quarterly or annually, from the date of the submission of the quarterly or annual financial report, respectively, as reported to the Federal awarding agency or pass-through entity in the case of a sub-recipient. Federal awarding agencies and pass-through entities must not impose any other record retention requirements upon non-Federal entities.

The three-year record retention period applies to all financial and programmatic records, supporting documents, statistical records, and other records that pertain to each countywide cost



allocation plan. For the purposes of this handbook, this three-year period begins on the date the State Controller receives the countywide cost allocation plan supported by the records.

If any litigation, claim, negotiation, audit, or any other action involving the records has started before the expiration of the three-year period, all records that may be reasonably assumed to be relevant must be retained until completion of the action and resolution of all issues that arise from it, or until the end of the regular three-year period, whichever is later. Records that pertain to any non-expendable property upon which claims for federal reimbursement have been made must be retained for three years after final disposition of the properties.

### **Section 2190: Access Rights**

Agencies that award grants, and the SCO in its capacity as the cognizant agency, have the right of access to any relevant books, documents, papers, electronic data, and other records that are pertinent to the cost plan in order to make audits, examinations, excerpts, and transcripts. The rights of access are not limited to the required retention period but continue as long as these records are retained.

These guidelines constitute the record retention policy for cost allocation plans only. Retention periods for financial, statistical, and other related information for any grant program are not addressed here. The grantee should contact the grantor agency and receive written permission before destroying any records pertinent to a grant program.

### **Section 2195: Summary**

In summary, adherence to the following basic concepts is vital when preparing the countywide cost allocation plan:

- Complete knowledge of county organization is necessary, including familiarity with county structure, activities and operations performed, and the resources used to conduct county operations.
- A working knowledge of federal requirements is desirable, including the costing principles contained in 2 CFR Part 200, ASMB C-10, and this handbook, as well as any program regulations or limitations established or imposed by grantor agencies.
- The ability to support the cost plan with complete and accurate financial and statistical records is imperative. These records should be the products of an accounting system that has installed a comprehensive system of working checks and balances. Costs and credits should be treated properly and consistently. Any decisions or interpretations and the supporting rationale should be thoroughly documented. A clear, comprehensible, and complete audit trail must be maintained, linking the cost plan with all of the information used in its preparation.

## **Section 2200: Costs, Revenues, Reimbursements, and Other Credits**

When developing the mechanisms that provide the data used in compiling a cost plan, it is imperative that the actual costs included in the cost plan are reconciled to the county's financial statements or actual costs as shown in the county's budget. A schedule showing this reconciliation must be included in the cost plan whenever the relationship between the two is not apparent. The costs allocated through a cost plan must be net of all revenues, reimbursements, and other credits applicable to any particular cost center.

### **Section 2210: Allowable Income (Revenue)**

Central service or program income may include income (revenue) from fees for services performed, from the use or rental of real or personal property and from the sale of real property, equipment, and/or personal property. Income from taxes, special assessments, levies, fines, and other revenues may not be included unless such revenues are specifically identified as program income in a grant agreement or in federal agency regulations.

### **Section 2215: Applicable Credits**

Applicable credits refer to those receipts or reductions-of-expenditure-type transactions that offset or reduce expense items allocable to the federal award as direct or indirect costs. Examples of such transactions include: purchase discounts, rebates, or allowances; recoveries or indemnities on losses; insurance refunds or rebates; and adjustments of overpayments or erroneous charges.

As indicated in 2 CFR Part 200, Section 200.406, in some instances, the amounts received from the federal government to finance activities or service operations of the non-federal entity should be treated as applicable credits. Specifically, the concept of netting such credit items (including any amounts used to meet cost sharing or matching requirements) should be recognized in determining the rates or amounts to be charged to the federal award. (See Sections 200.436 Depreciation and 200.468 Specialized Service Facilities, for areas of potential application in the matter of Federal financing activities.)

### **Section 2220: Examples of Applicable Credits**

Prior to expenditure allocation, any particular credit or service that cannot be attributed directly to a specific benefitting department or agency must be deducted from the total costs of the department or cost center that provided the service. If a credit can be identified to a particular department or agency, it should be deducted from the total allocations to the departments or agency. Following are examples:

- A county maintains its workers' compensation insurance with the State Workers' Compensation Insurance Fund. Any premium reimbursements received from this fund would be used, prior to allocation, to reduce the current premium charges. However, if the reimbursements pertain to a portion of the premium charged to a *specific* department, such as public works, then the credit should be applied only to that department.

- For a fee, the County Auditor-Controller's staff conducts audits for a local school district. This revenue should be deducted from the cost center's cost allocation to the school district.
- For a small charge per copy, county employees and the general public may use county photocopy machines for personal business. This revenue constitutes an incidental service and, prior to the allocation process, amounts collected should be prorated to the applicable department's cost pools and deducted from the department's costs.
- A county's Graphic Arts department allows one of its illustrators to prepare drawings and illustrations for a monthly employee union newsletter. The union pays for these services when they are performed on county time and at county expense. The revenue received would be considered recompense for a personal service and deducted from the total cost of the department prior to allocation.
- A county department conducts a conference to provide information on new grant procedures and regulations. The attendees, grant participants, and sub-grantees pay a registration fee for attendance. All fees collected must be deducted from the costs of the conference before reimbursement can be claimed from the grantor agency.
- Several automobiles have been purchased for use in the county's Social Services department using grantor agency and county matching funds. Should some other grantee program use one of the autos, this second program would not be able to claim reimbursement from its grantor agency for the use or depreciation of the car because it had already been acquired with federal and/or matching funds. This would also be true if a service department used one of these cars. Because these vehicles were acquired with federal and other matching funds, a service department would not be able to include use or depreciation charges for these cars in the total costs that it allocates to other departments.
- A department has employees who are funded through a federally reimbursed employment program. If this is a central services department, reimbursed salaries and benefits must be removed prior to allocation of the department's costs. If the department is an operating department, previously reimbursed costs cannot be included in any federal or state claim for reimbursement.

### **Section 2230: General Billing Requirements**

Counties must meet certain requirements in developing the billing mechanisms for departments charging for services. Any ISF or central service budget unit that bills for its services must provide all of the following:

- A description of the types of services provided and their relevance to federal and state programs conducted by the county;
- The items of expense included in the cost of each service;

- Identification of the departments that received services;
- A concise and complete description of the method used to develop the billing rate or rates used in charging for services;
- A concise and complete description of the accounting treatment and method of adjusting any over/under-recovered costs at fiscal year-end; and
- A listing of all non-operating transfers into and out of the fund.

Unless approved in the current Cost Plan Negotiation Agreement concluded between the county and the SCO, county departments may not claim reimbursement for direct billings from grantor agencies.

Counties may directly charge operating departments for 2 CFR Part 200 central-support services that have been allocated to them in the cost plan. If these cost plan charges are not applied to reduce cost plan allocated costs, controls must be put in place to ensure that the amounts charged are not claimed as direct costs on any grant claims for reimbursement. The practice of directly charging 2 CFR Part 200 allocations must be fully explained in cost plan narratives.

### **Section 2235: Internal Service Funds (ISFs)**

Cost plans should treat proprietary funds as operating departments when allocating indirect costs. GASB Cod. Sec. 2200.156 (Section 2200, Paragraph 156) identifies two types of proprietary funds: enterprise funds and internal service funds (ISFs). It notes that proprietary fund reporting focuses on the determination of operating income, changes in net positions (or cost recovery), financial position, and cash flows.

GASB Cod. Sec. 1300.110 (Section 1300, Paragraph .110) states that ISFs may be used to report any activity that provides goods or services to other funds, departments, or agencies of the primary government and its component units, or to other governments, on a cost-reimbursement basis. ISFs should be used only if the reporting government is the predominant participant in the activity. Otherwise, the activity should be reported as an enterprise fund.

The charges by each ISF attempt to recover sufficient revenues to fund all the costs associated with providing goods and/or services, including indirect (allocated) costs. An ISF's objective is not to make a profit but to recover, over a period of time, the total costs of providing goods or services. GASB Cod. Sec. 1300.110 (Section 1300, Paragraph .110) and 2 CFR Part 200, Appendix IV require ISF rates and billings for goods and services to be cost based, employing an approved cost accounting and/or cost allocation system. Such a system will supply information beyond that supplied by a county's general accounting records but will reconcile to those records. All users of an ISF should be billed directly in order to ensure equitable charges to all units that have received the ISFs goods or services. If all users are not equitably billed, the fund must prepare a schedule reconciling actual charges to the amounts that should have been charged in an equitable system.

Each ISF should regularly prepare and examine its financial condition at least midway through each fiscal year. If a material profit or loss is projected for the end of the fiscal year, the fund's billing rates should be adjusted during the year. An immaterial deficit or profit at year-end should be offset by adjusting the billing rates for the following fiscal period. ISFs should not produce any significant profit or loss in the long run. An ISF's billing rates should be designed to recover the entire cost of its operations, including the indirect overhead and central support service costs identified in the cost plan. These costs should be charged to and paid by the ISF as part of its ongoing operations costs. All cost plans should treat ISFs as operating departments when allocating indirect costs.

#### **Section 2240: Adjusting ISF Billing Rates**

Each central service activity, including proprietary funds, must separately account for all resources received by the service (including imputed resource gains), expenses incurred by the activity to furnish goods and services, and profit and/or loss. The differences between assets and liabilities are net positions. Net positions should be reported in three categories: "invested in net positions, net of related debt (and accumulated depreciation)"; "restricted"; and "unrestricted." Net positions should be reported as restricted only when constraints are placed upon them either externally, as imposed by creditors, grantors, contributors, or laws or regulations of other governments, or when imposed by law, through constitutional provisions or enabling legislation.

#### **Section 2245: ISF Net Positions**

Unrestricted net positions consist of net positions that do not meet the definition of "restricted" or "invested in capital assets, net of related debt." Portions of unrestricted net positions may be "designated" to indicate that the management of the ISF does not consider these assets to be available for general operations. In contrast to restricted net positions, designated unrestricted net positions are constrained internally only by a fund's management, which may remove or modify the designations.

ISFs may include in their rates depreciation charges intended to recapture the original cost of a vehicle or other piece of equipment. Depreciation must be charged straight-line over a reasonable equipment life. Normally, equipment life is determined by applying the Internal Revenue Service Alternative Depreciation System (straight-line) recovery periods. Deviations from these recovery periods must be supported by detailed analysis. Depreciation charges collected must be matched to the individual items of equipment for which the depreciation was charged and must be discontinued when an item of equipment is fully depreciated. Amounts collected as depreciation charges for an item of equipment must be made available for expenditure when that piece of equipment is replaced or removed from service. ISFs may impose a replacement charge in their rates to compensate for estimated increases in the cost of equipment purchased.

Replacement/inflationary charges may not be claimed for reimbursement by grant departments. Amounts charged above the original cost of equipment must be removed from the rates charged to grant departments or specifically identified to these departments so that they are not included in requests for grant reimbursement. Estimated replacement/inflation charges must be re-evaluated and adjusted no less frequently than annually.

In addition to the full recovery of costs, charges by an ISF may provide for the establishment and maintenance of a reasonable level of working capital reserve. Unrestricted, undesignated net

positions up to the amount required to pay for 60 days of average cash expenses are considered a reasonable working capital reserve. Each year, counties must provide a thorough analysis of the net positions held by each of their central service ISFs at the end of the cost plan's base year. Counties should fully report their unrestricted net positions and describe the portions of these assets that are designated so that the acceptability of each ISF's working capital may be evaluated during the desk review of the county's cost plan. If an ISF's working capital chronically exceeds the amount established as allowable by 2 CFR Part 200, the ISF will be deleted from Section II, Costs Distributed Through Billing or Cost Transfer Mechanisms, of the county's negotiation agreement and grant agencies will no longer be authorized to claim reimbursement for charges that were imposed by that ISF. The rationale and methodology for the designation of net positions must be fully supported and auditable. Transfers, reclassifications, or expenditures of any central support net positions reported to the SCO as reserved or designated for any purpose other than the purposes for which these assets were designated or reserved must be approved by the SCO County Cost Plans Unit.

For those funds that use multiple billing rates, such as Information Technology ISFs, a separate net position and working capital reserve calculation may be required for each billing rate or service. An overall/average ISF working capital reserve may not be appropriate because excess charges may occur in one billed service but undercharges may occur in other billed services. In addition, various users do not use each/all billed services to the same extent. For example, an Information Technology ISF should not overcharge Main Frame services in order to undercharge other services within the ISF.

### **Section 2250: ISF Loans**

An ISF may make loans only to other county funds, subject to the following restrictions:

- The loan must be recorded as an account receivable in the ISF's financial records;
- The loan must be repaid with interest, and the interest computed at the same rate that the ISF could have earned had the loan not taken place;
- The period of the loan must not exceed 36 months;
- The loan must not impact adversely on the ISF's current cash requirements;
- The loan must be included in the measurement of the ISF's assets for any actuarial purposes; and
- The loan agreement must include a clause that permits the ISF to demand accelerated repayment of all or any part of the loan if its cash requirements so dictate.

If a loan made by an ISF is not fully repaid by the end of the loan period, the loan is regarded as a "bad debt" and requires an immediate rebate to all grant programs from the county general fund.

### **Section 2255: Self-Insurance Funds**

2 CFR Part 200, Appendix V, Section E.3 c, requires that counties provide the following information to the SCO whenever a self-insurance fund is included in a county cost plan or when departments or agencies claim reimbursement for self-insurance charges:

- A fund balance sheet;
- A statement of revenues, expenses, and changes in net fund assets or fund equity, including a summary of billings and claims paid by the fund;
- A listing of all non-operating transfers into and out of the fund;
- The type or types of risks covered by the fund;
- An explanation of how the level of fund contributions is determined, including a copy of the current actuarial report (with the actuarial assumptions used) if the contributions are determined on an actuarial basis; and
- A description of the procedures used to charge or allocate fund contributions to benefitted activities.

The board of supervisors of a county may, by resolutions, establish and maintain a reserve account to insure against its liability or the liability of its employees for injuries or property damages, for liability under the workers' compensation laws, for casualty losses sustained by the county, and for providing health and welfare benefits for its employees. Reserves maintained by county insurance funds may be no greater than the amounts recommended by the county's actuaries. Contributions to reserves must be based upon sound actuarial principles using historical experience and reasonable assumptions. All insurance reserve levels must be analyzed and updated no less frequently than once every two years.

### **Section 2260: Distribution Formula**

Charges for liability and for workers' compensation insurance contributions and/or expenses must be distributed to departments/funds employing a combination of 60% to 80% experience and 40% to 20% exposure for each type of coverage. The loss history used each year should consist of losses for the five to seven most recent years and should be reviewed and updated at least annually. Losses charged to departments and/or funds may be limited to a maximum amount (capped) as long as these losses are treated uniformly and consistently. Please see Section 4280 Risk Management Cost Identification for further discussion.

Insurance reserve levels and loss histories should be derived using claims:

- Paid;
- Submitted and adjudicated but not paid;
- Submitted but not adjudicated; and

- Incurred but not submitted (these amounts must be identified and explained).

### **Section 2265: Probable Incurred Liability**

Claims submitted but not adjudicated and claims incurred but not submitted should be recognized if it is determined that it is probable that a liability for each such claim has been incurred and if the amount of the loss can be reasonably estimated. If there is a potential range of losses for a claim, then the most likely amount of the loss should be selected. If no single amount within a probable range of losses is most likely to occur, then the minimum value in this range should be recorded as the expected loss. Information on claims submitted but not adjudicated and claims incurred but not submitted must be reviewed and updated as additional information becomes available.

### **Section 2270: Central Support Budget Units**

Central support budget units transfer their expenditures completely or partially to other budget units through direct charges. The residual unbilled expenditures represent costs that have not been reimbursed and that can be allocated in the cost plan, along with any indirect overhead associated with the unit. Indirect overhead allocations should be based upon the original charges to the user departments.

The methodologies used to develop the amounts charged to user departments must be consistently applied to all departments charged.

### **Section 2275: Partial Direct Billing**

There may be times when it is impractical to directly charge all user departments. In such instances, partial direct billing is permitted for grant reimbursement purposes. Costs must be equitably allocated to all benefitting departments, and amounts directly charged to any departments must be applied to reduce the associated allocation to these departments. Over two or more fiscal periods, no user department may be consistently and materially overcharged. If any department, grantee or otherwise, is consistently and materially overcharged, then the county will be required to either revise its method of developing charges to a methodology approved by the SCO or discontinue direct charging. Failure to rectify overcharges will result in denial of claims for reimbursement for these direct charges.

Federal costing principles prohibit costs allocable to one user department from being moved to another user department.

Billing rate methodologies used should result in fair and equitable charges that are consistently applied to all users of the service. No program or department may be burdened with charges that are identifiable to other programs or departments.

### **Section 2280: Memo Billing**

The specific relationship of billings between a county's central support and operating departments is an area over which the SCO has cognizance. Because "memo billing" presents the potential for an accidental duplication of recovery, the SCO prohibits its use.



Memo billing refers to the practice of one county department providing goods or services to another and identifying the costs to the receiving department only via interdepartmental correspondence. The goods or services may be of a countywide support nature or used solely in the performance of a specific element of a grant program. The absence of journal entries, recording the transfer of costs, in the accounting records of either the servicing or the receiving department distinguishes memo billings from direct billings or intrafund transfers.

Memo billings become a matter of concern to the SCO when goods and/or services are provided between a service and a grantee department. For example, the county Department of Collections notifies, or “memo bills,” the county Family Support Division for collection services provided by the department of collections with a value of \$50,000 during a fiscal year. Family Support claims the “memo bill” amount as a direct cost. When the cost plan for the same fiscal year is prepared, the \$50,000 will be directly identified and included in the allocation of costs to Family Support. No credit adjustments will be included in the Countywide Cost Allocation Plan to offset this allocation because the “memo bill” amount was never recorded in the accounting records. As a result, 2 CFR Part 200 costs identified to Family Support in the cost summary/exhibit will include an amount that has been previously claimed as a direct cost. This duplication is unallowable for grant reimbursement purposes.

### **Section 2290: Allowable Necessary Costs**

The SCO’s cognizance, however, extends only to the matters addressed in 2 CFR Part 200, ASMB C-10, this handbook, and associated principles and policies. At times, other county operating departments may undertake various functions of a grant program under a cooperative interagency, or memorandum type of agreement. If these services relate directly to the grant program, they should be considered direct costs of the total grant program, whether or not they are billed to the grant department.

As long as these costs are recorded on the accounting records of the county, represent actual identified costs, are identified by a cost accounting system or departmental indirect cost proposal, and/or are substantiated by cost records, they are acceptable as direct costs of the grant program. Such costs may be claimed for reimbursement regardless of the budget unit in which they are recorded. The guiding standard is that the grantor agency should fund the costs associated with a particular grant program, not specifically the costs of a particular budget unit. A necessary cost of a grant program is allowable regardless of where it is incurred within a county government organization.

2 CFR Part 200 cost principles do not specify a particular form of organization, management technique, or method of accounting as a condition for cost reimbursement for federal grants and contracts. Consequently, the accumulation and claiming of direct costs by recipient agencies are matters that must be agreed upon between grantor and grantee agencies.

## Exhibit 2201: Cost Plan Terminology

Listed below are the definitions for a number of key words that could affect the preparation of a cost plan. For additional definitions, refer to 2 CFR Part 200, Subpart A, Section 200.1; 2 CFR Part 200, Appendix V, Section B; and 2 CFR Part 200, Appendix VII, Section B.

<u>Key Word</u>	<u>Definition</u>
Actual Year	The fiscal year that reports the actual costs experienced by the non-federal entity.
Billing	The system whereby the costs of providing a particular service or benefit are accumulated and charged to the receiving department, fund, or entity.
Cost	The assigned value of goods or services denominated in dollars.
Cost Accounting	The method of accounting that provides for the accumulation and recording of all the elements of cost incurred to accomplish a purpose, to carry on an activity or operation, or to complete a unit of work or a specific job.
Cost Accounting System	The term used to describe the system that provides for the implementation of cost accounting. Cost accounting systems may be manual, partly automated, or fully automated.
Cost Analysis	The process of determining the cost of a particular operation or service by analyzing the financial and cost records, but without formally recording the results in cost ledgers, as in a cost accounting system. Cost analysis is an essential component of cost allocation methodology.
Cost Applied (Process)	Please see Intrafund Transfers.
Cost Ledger	The term used to describe the subsidiary record in which various operations and/or services are posted in detail. Such accounts should be arranged and kept so that the results shown in them may be summarized in a control account. Cost records must be reconciled to and verified by a control account or accounts in the general ledger and/or object expenditure records.
Cost Plan Year	The fiscal year that estimates costs based on the actual costs from a previous fiscal year.
Cost Records	All ledgers, supporting records, schedules, reports, invoices, vouchers, and other records and documents that reflect the cost of projects, jobs, production centers, processes, operations, products, services, or the costs of any of the component parts.

<u>Key Word</u>	<u>Definition</u>
Cost Unit	The term used in cost accounting to designate the unit of product or service whose cost is computed. These units are selected for the purpose of comparing the actual cost with a standard/budgeted cost or with actual costs of units produced under different circumstances or at different places and times.
Departmental Indirect Cost Rate Proposal (ICP or ICRP)	The method used to distribute the countywide 2 CFR Part 200 costs plus departmental administrative costs to the various programs within a department. A rate is often applied to direct program costs.
Direct Billing	The process whereby one entity charges another for the cost of specifically identified goods or services. Direct billings may result in revenues, interfund transactions, or intrafund transfers, depending on whether the payments received for direct billings are received from non-governmental agencies, other governmental funds and agencies, or other budget units that are included in the fund providing the goods and services. The goods and/or services furnished and related income realized must be completely documented. Any income from direct billings for costs that are also allocated through the cost plan must be either credited to the entities from which the income was derived or used to reduce total cost plan expenditures.
Direct Cost, Expenditures, and Expenses	Reductions in assets that are traceable to specific goods, services, units programs, activities, or functions. Direct costs/expenses differ from indirect costs/expenses. Indirect costs/expenses cannot be specifically traced and must be allocated on some systematic and rational basis.
Expenditures	Reductions in the net financial resources of a fund. This term is used to describe the outflow of financial resources in a fund that employs the modified accrual basis of accounting.
Expenses	Outflows or other expending of assets or incurring of liabilities or combination of both from delivering or producing goods, rendering services, or carrying out other activities that constitute an entity's ongoing operations during a set period. The term applies to activities that diminish the economic position of entities and is used by funds that employ the accrual basis of accounting.
Fiscal Year	A fiscal year is an accounting period of 365 days or 12 consecutive months that does not necessarily correspond to the calendar year beginning on January 1 <sup>st</sup> . The fiscal year is the established period of time when an organization's annual financial records commence and conclude.

<u>Key Word</u>	<u>Definition</u>
Flow of Economic Resources	All assets available to a non-federal entity for the purpose of providing goods and services. This classification refers to the accrual basis of accounting that is used by proprietary funds (internal service funds and enterprise funds).
Flow of Total Financial Resources	All of the monetary assets and monetary liabilities that arise from operations. This measurement focus is used in modified accrual government financial reporting.
Indirect Costs (Overhead)	The elements of cost necessary in the production of a good or service that are not directly traceable to the product or service. Usually these costs relate to objects or expenditures that do not become an integral part of the finished product or service, such as rent, heat, light, supplies, management and supervision.
Interfund Transaction	Transactions that occur between funds of the same government reporting entity.
Interfund Transaction-Interfund Loans	Loans made by one fund to another.
Interfund Transaction-Operating Transfers	All interfund transfers other than residual equity transfers (e.g., legally authorized transfers from a fund receiving revenue to the fund through which the resources are to be expended).
Interfund Transaction-Quasi-External Transactions	Interfund transactions that would be treated as revenues, expenditures, or expenses if they involved organizations external to the non-federal entity. Such transactions include: payments in lieu of taxes from an enterprise fund to the general fund; internal service fund billings to departments; routine employer contributions to a pension trust fund; and routine service charges for inspections, engineering, utilities, or other services provided by a department financed by one fund to a department financed by another fund. In the funds involved, these transactions should be accounted for as revenues, expenditures, or expenses.
Interfund Transaction-Reimbursements	Repayment of amounts remitted on behalf of another party, or interfund transactions that constitute reimbursements of a fund or expenditures or expenses initially made that properly apply to another fund. For example, an expenditure properly chargeable to a special revenue fund is initially made from the general fund and is subsequently reimbursed. These transactions are recorded as expenditures or expenses (as appropriate) in the reimbursing fund and as reductions of the expenditures or expenses in the fund that is reimbursed.

<u>Key Word</u>	<u>Definition</u>
Interfund Transaction- Residual Equity Transfers	Nonrecurring or non-routine transfers of equity between funds. For example, contribution of enterprise fund or internal service fund capital by the general fund, subsequent return of all or part of such contribution to the general fund, and transfers of residual balances or discontinued funds to the general fund or a debt service fund.
Interfund Transfers	Interfund transfers can be classified as belonging to one of two major categories: operating transfers or residual equity transfers.
Intrafund Transfers	Transactions between a primary government and its blended component units, or transfers among the blended units of a government fund. This handbook uses the term primarily to describe transfers between operating and central support budget units of the general fund. Intrafund transfers are sometimes referred to as cost applied. The intrafund transfer process consists of a transfer of all or part of a budget unit's costs to other budget units in the same governmental type fund. This is accomplished by reducing expenditures in budget units to which the expenditures were originally charged and increasing the corresponding expenditures in other budget units of the same fund to which these expenditures actually apply. Intrafund transfers that are a consequence of direct charges for services must be clearly and completely describe and accounted for by budget unit, so they may be properly applied to cost allocations.
Memo Billing	Values assigned to goods and services that are not recorded on a county's accounting records. The value of the goods or services provided by one department to another is indicated by interdepartmental communication; however, the charge is not recorded in the general journal, the expenditure ledgers, or in any other accounting record. The SCO does not permit costs supported by memo billings to be applied in any aspect of cost plan preparation or application. If these billings are used internally for some purpose other than cost assignment between central support service and operating departments, they must be supported by cost analysis and detailed cost records.

Key Word

Definition

	<p>A cost associated with providing a particular service or activity. Program costs may be direct or indirect. A program cost:</p> <ul style="list-style-type: none"><li>• Increases in the net current assets of a government type fund, from other than expenditure refunds, capital contributions, operating transfers, and residual equity transfers. General long-term debt proceeds and transfers in are classified as “other financing sources” rather than revenues.</li><li>• Increases in the net total assets of a proprietary type fund, from other than expense refunds, capital contributions, operating transfers, and residual equity transfers.</li></ul>
Program Costs	
Unit Cost	<p>The cost of producing a unit of product or rendering a unit of services (e.g., the cost of performing a tune-up on one sedan).</p>
Work Unit	<p>The term used to describe a fixed quantity that will consistently measure work effort expended in the performance of an activity or the production of a good.</p>

## **Section 2300: Allowable Compensation for Personnel Services**

Allowable compensation for personnel services is extensively addressed in 2 CFR Part 200, Section 200.430, and ASMB C-10, Part 3, items 3-5 through 3-24, as well as in this handbook.

Allowable grant program costs for personnel services are comprised of costs directly associated with the program and costs indirectly associated with the program through the central support service departments identified in the countywide cost allocation plan.

### **Section 2310: Required Supporting Documentation**

2 CFR Part 200, Section 200.430, discusses the supporting documentation requirements of charges claimed for salaries and wages. It imposes the condition that charges to federal awards for salaries and wages, whether treated as direct or indirect costs, be based on payrolls documented in accordance with the generally accepted accounting practice of the non-federal entity and approved by a responsible official or responsible officials of the non-federal entity. All salaries and wages included in the cost plan must meet this minimum requirement. Additionally, because counties have many different grant programs, each set of grant regulations should be reviewed to determine if there are additional payroll or time documentation requirements.

Charges for the salaries and wages of employees working solely on a single federal award or cost objective must be supported, at a minimum, by periodic certifications that the employee worked only on that program for the period covered by the certification. These certifications must be prepared at least semi-annually and must be signed by the employee and a supervisory official having first-hand knowledge of the work performed by the employee.

Employees who work exclusively in a single indirect cost pool must each sign their normal payroll documentation. Each employee's supervisor must formally approve the employee's time report. No further documentation is required for cost allocation purposes.

Exhibit 2301 provides examples of time-reporting requirements for various personnel positions.

### **Section 2320: Personnel Activity Reports**

When employees work on two or more activities or cost objectives, and/or when their activities are directly identified or directly billed to particular budget units or agencies, the distribution of their salaries or wages must be supported by personnel activity reports.

Exhibit 2302 is an example of a personnel activity report, completed daily and summarized on a monthly basis. It tracks all time spent on projects of a specific nature as well as those activities that are continuous or ongoing by nature. Personnel activity reports may be maintained either electronically or manually. In all cases, to be acceptable as documentation for personnel services, all personnel activity reports must:

- Reflect an after-the-fact distribution of each employee's actual activity;
- Account for the total activity for which each employee is compensated;

- Provide full and complete substantiation of the distribution of effort and support the imposition of any direct charges for services;
- Be prepared at least monthly, and fully account for the total labor hours of each month;
- Be signed and dated by the employee no later than the end of the pay period that follows the pay period covered by the report; and
- Document, by signature or initials and date, after-the-fact supervisory review and approval of each activity report.

“Electronic signatures” are acceptable if a department that uses automated time reporting can prove that only the actions of the individual preparing a personnel activity report would produce entries on that report or the report includes a digital signature that identified a unique individual as the preparer of the electronic report. Such reports require physical or unique electronic documentation of supervisory review and approval.

Counties are encouraged to use a personnel activity reporting system, as described above, for employees in all departments, including those departments performing duties considered to be unallowable for grant reimbursement purposes. Reporting in a format such as this is mandatory for any employee who works on multiple activities or cost objectives, whose activities are indirectly identified to a particular activity and/or activities, or whose efforts are directly billed.

### **Section 2330: Acceptable Substitute Systems**

Substitute systems for allocated salaries and wages are acceptable if the county can demonstrate that such substitutions are statistically valid and if these substitute systems are approved by the SCO prior to being implemented.

In order to be statistically valid, statistical sampling requires that the population selected for examination be a complete population. The sampling must also meet the following requirements:

- All employees whose salaries and wages are to be allocated for the accounting period under examination must be included;
- The entire time period involved must be covered by the sample;
- The sampling units must be selected from the defined population so that each sampling unit has a chance of being selected;
- There must be a known probability of selection;
- The sample must be selected randomly and apply to the period being sampled (see ASMB C-10, Part 3, Section 3-23);
- The means of determining the sample size must be quantified; and



The sample results must be mathematically evaluated.

### **Section 2340: Purpose of Documentation**

Direct charges, direct identification of effort, and allocation of professional and nonprofessional salaries and wages in cost plans must be supported as detailed in Sections 2310 and 2320, Required Supporting Documentation and Personnel Activity Reports, respectively. The fundamental purpose for this documentation of time applied is to obtain the requisite specificity to ensure that efforts expended are accurately identified to cost pools and/or individual departments and that charges for services supplied are entirely supported. This is particularly important when individuals work in departments that may perform both allowable and unallowable functions, work on more than one federal award, work on both federal and non-federal awards, work on an indirect cost activity and a direct cost activity, work on two or more indirect activities that are allocated using different allocation bases, or work on an unallowable activity and an allowable direct or indirect cost activity. Additionally, each cost plan schedule's general and administrative expenditures are distributed to the other cost pools in that schedule using these cost pools' salary and wages expenditures.

Any and all exceptions to these standards for cost plan and direct billing time distribution documentation must be formally requested and approved in advance by the SCO.

### **Section 2350: Summary**

The above guidelines constitute the minimum substantiation required if salary and wage information is to be included in cost plans approved by the SCO. Counties are encouraged to implement more extensive documentation, in the form of 100% continuous time studies for all activities. It is the prerogative of each county, however, to determine if the costs of collecting the personnel service information exceeds the reimbursement that will be realized from the inclusion of the costs of these services in their cost plans or direct billings.

## Exhibit 2301: Examples of Time-Reporting Requirements

<u>Department</u>	<u>Position</u>	<u>Minimally Acceptable Time-Reporting Records</u>
<b>County Administrative Office</b>	<b>Administrative Analyst working only on budget issues for the county departments prior to the consolidation for presentation to chief executive office</b>	<b>Payroll records documented in accordance with generally accepted accounting standards and approved by the employee's supervisor</b>
<b>Auditor-Controller's Office</b>	<b>Accounting Technician providing services only to the county's Social Services Department</b>	<b>Payroll records and certificates completed at least after each month period, signed by the employee's supervisor</b>
<b>Auditor-Controller's Office</b>	<b>Accountant performing duties that may be assigned to more than one cost pool</b>	<b>Payroll records and after-the-fact personnel activity reports prepared at least monthly, accounting for total reimbursed activity, completely substantiating the distribution of effort, signed by the employee, and approved by the employee's supervisor.</b>
<b>County Counsel's Office</b>	<b>Attorney whose services are directly charged or directly identified to one or more county departments</b>	<b>Payroll records and after-the-fact personnel activity reports prepared at least monthly, accounting for total reimbursed activity, completely substantiating the distribution of effort, signed by the employee, and approved by the employee's supervisor.</b>

# Exhibit 2302: Sample Personnel Activity Report

PERSONNEL ACTIVITY REPORT  
SECTION  
DISTRIBUTION OF ACTUAL TIME AND ACTIVITY FOR THE MONTH OF           2          

		1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	22	23	24	25	26	27	28	29	30	31	MONTH SUMMARY		
Pool Car Mileage																																			
Private Car Mileage																																			
Rental Car Mileage																																			
External Office Hours																																			
PROGRAM																																			
Hours																																			
General Cnvt.																																			
General Assistance																																			
Training																																			
Administration																																			
Other (specify)																																			
PROGRAM HOURS																																			
Sick Leave																																			
Vacation																																			
Other Absences																																			
TOTAL HOURS																																			

Exhibit 2302  
Sample  
Personnel  
Activity  
Report

DATE: \_\_\_\_\_ NAME: \_\_\_\_\_  
 DATE: \_\_\_\_\_ SIGNATURE: \_\_\_\_\_ Date: \_\_\_\_\_  
 DATE: \_\_\_\_\_ APPROVED: \_\_\_\_\_ Date: \_\_\_\_\_

## **Section 2400: Allowable and Allocable Support Services and External Overhead Costs**

The total costs of the operations of county departments are comprised of direct and indirect costs. Allowable direct costs plus allowable indirect costs net of all revenues, reimbursements, and credits make up the total costs that may be reimbursed by federal and state governments. Allowable costs in the context of a countywide cost allocation plan consist of the direct and indirect costs that are considered to be eligible for reimbursement under the provisions of 2 CFR Part 200 or that are specifically authorized by the terms of a particular federal or state grant. If a cost benefits a grant program and can be identified to that program, it may be included with all other direct costs of that program for grant reimbursement purposes unless it is specifically prohibited or limited by law or other governing directive. Indirect costs, although they may not be readily assignable to cost objectives because they benefit more than one cost objective, must provide specific benefit to each of the cost objectives to which they are allocated.

### **Section 2410: Classifying Costs**

There are no universal rules for classifying costs as either direct or indirect. A cost may be direct with respect to some specific service or function and may also be indirect with respect to a federal award or some other final cost pool. However, each item of cost should be treated consistently in like circumstances either as a direct or an indirect cost.

2 CFR Part 200, Appendix IV, Section A, Paragraph 1, defines indirect costs as those costs:

1. Incurred for common or joint objectives; and
2. Cannot be readily identified with a particular final cost objective.

The term “indirect costs,” as used herein, applies to costs of this type originating in the grantee department, as well as those incurred by other departments in supplying goods, services, and facilities. To facilitate equitable distribution of indirect expenses, to the cost objectives served, it may be necessary to establish a number of pools of indirect costs within a non-Federal entity department or in other agencies providing services to a governmental unit department. Indirect cost pools should be distributed to benefitted cost objectives on bases that will produce an equitable result in consideration of relative benefits derived.

### **Section 2420: Allowable Activities**

Following are examples of some general county activities that constitute allowable expenditures for allocation:

- Allowable costs within a centralized budget office relate to both the budget formulation and the budget execution activities. Costs considered allowable within the budget formulation activity are those incurred in the development of the agency budgets prior to the point where they are consolidated and submitted to the chief executive. This would include the development of guidance on the preparation of the individual operating department/agency budgets, the development of forms and related instructions, assisting those departments/agencies in the preparation of their individual budgets, and the review

and analysis of the individual budgets. Allowable costs related to the budget execution activity are those incurred in controlling and managing a budget (appropriation) for a given year.

- General accounting procedures, which include the costs of recording expenditures in the accounting records and matching them against appropriations, are an integral part of maintaining central accounting records and are allowable. This is a component of internal control and is necessary for the proper and efficient administration of grant programs.
- Audit services are allowable, provided the audits were performed in accordance with the Single Audit Act. Generally, the percentage of costs charged to federal awards for a single audit shall not exceed the percentage derived by dividing federal funds expended by total funds expended by the recipient or sub-recipient (including programs matching funds) during the fiscal year. This percentage may be exceeded only if appropriate documentation demonstrates higher actual costs. Other audit costs are allowable if they meet the criteria set forth in 2 CFR Part 200 Section 200.425. In general, the following are examples of allowable other audit costs:
  - The costs of auditing the financial statements for non-Federal entities subject to the requirements of the Single Audit.
  - A proportionate share of the cost of a financial statement audit, including those performed under Generally Accepted Governmental Auditing Standards (GAGAS), by an entity exempted from the Single Audit.
  - Internal audit functions and its related costs that are performed to support the Single Audit, the financial statement audit, or are part of the systems of internal controls required by 2 CFR Part 200, Section 200.303. The costs must be appropriately allocated to the indirect cost pool in an indirect cost rate proposal or cost allocation plan.

The costs of collecting the information supporting an amount included in the cost plan must be measured against the return that will be realized. Personnel preparing cost plans must explain in the narratives that accompany each plan why certain costs were treated allowable or unallowable.

### **Section 2430: Interpreting Allowable Costs and Activities**

Questions often arise as to what costs are allowable, what costs benefit grants departments, and what activities should be considered as general government. Among the units where ambiguities may occur are the departments of the county administrative officer, the auditor-controller, the treasurer-tax collector, and the county counsel. The following general guidelines may be helpful when determining if various central support functions are allowable.

Allowable costs are usually administrative or supportive in nature and the benefits associated with them flow into an organization, as described in 2 CFR Part 200, Subpart E. Allowable functions include activities that are required by or provide specific benefits to federal and/or state programs or other county departments. Some examples are:

- Services provided in response to requests from other county departments;
- Functions, identified by time studies, that directly benefit grant programs or are identified to departments or activities that are necessary and reasonable for proper and efficient administration of grant programs. These functions may be allocated to such programs under principles outlined in 2 CFR Part 200, and constitute costs that may be included in a countywide cost allocation plan. Details of allowable costs are presented in 2 CFR Part 200, Subpart E.

#### **Section 2440: Unallowable Costs and Activities**

Unallowable activities include activities not affected by the existence of federal and/or state programs or the operation and administration of county departments. These costs do not provide specific benefits to any cost objectives. Examples are:

- Services performed at the request of the board of supervisors;
- Reports to the board regarding the effect of proposed operations on overall county tax rates;
- Activities that cannot be identified with a grant program and that do not benefit any grant programs;
- General functions that are required to carry out the overall responsibilities of state or local governments but do not benefit any grant programs;
- Purchase of alcoholic beverages;
- Bad debts;
- Contingencies;
- Contributions;
- Defense and prosecution of criminal and civil proceedings and claims;
- Depreciation of land, any portion of buildings and equipment purchased by grant funds, or any buildings and equipment acquired as a part of a matching requirement;
- Fund raising and investment management, generally;
- Entertainment;
- Costs of prosecutorial activities unless treated as a direct cost to a specific program if authorized by statute or regulation activities of the Attorney General as described in

section 200.435 defense and prosecution of criminal and civil proceedings, claims, appeals, and patent infringement(s)

- Costs of the judicial branch of a government
- Salaries and other expenses of a state legislature, tribal council, or similar local government body, such as a county supervisor, city council, school board, etc., whether incurred for purposes of legislation or executive discretion
- Salaries and expenses of the Office of the Governor of a state or chief executive of a local government or the chief executive of an Indian tribe.
- Idle facilities and idle capacity;
- Interest on funds not loaned by a bona fide third party;
- Lobbying;
- Self-assessed taxes;
- The costs of audits that are not required by the Single Audit Act or 2 CFR Part 200, Subpart F, such as, evaluating the effectiveness and efficiency of a state or local government program (e.g. performance audits); and
- Audit services required by the state or local government to meet state or local government requirements, rather than, to comply with the requirements in 2 CFR Part 200, Section 200.303 or 2 CFR Part 200, Subpart F.

Any excess costs over the federal contribution under one award agreement are unallowable under other award agreements.

### **Section 2450: Factors Affecting the Allowability of Costs**

The allowability of different expenditures will vary due to circumstances or specific conditions of grant agreements. It is imperative that 2 CFR Part 200, Subpart E, ASMB C-10, and this handbook be carefully reviewed prior to including any expenditure in the cost plan. Any questions about the acceptability of any expenditure item or category should be resolved in consultation with the SCO.

Many allowable costs included in the cost plan are readily identifiable to those departments that benefit from the service activity. Examples are:

- Utility costs and janitorial work charged to a county building and allocated to building occupants using the number of square feet of occupancy;
- Personnel costs distributed using the number of employees per department; and

- Warrant processing costs allocated by the number of warrants issued.

### **Section 2460: Allocable Costs**

Some costs are not readily assigned. In general, these costs are incurred on behalf of the county and are allocable to particular cost objectives if the goods or services involved are chargeable or assignable to these cost objectives in proportion to the relative benefits received. Such costs must be allocated using a base that reflects the service they provide. All activities that benefit from a governmental unit's indirect costs, including unallowable activities and services donated to the governmental unit by third parties, must receive an appropriate allocation of indirect costs. Any cost allocable to a particular federal award or cost objective under the principles provided for in 2 CFR Part 200 may not be charged to other federal awards to overcome fund deficiencies, to avoid restrictions imposed by law or by terms of federal awards, or for any other reasons. This prohibition does not preclude governmental units from shifting costs that are allowable under two or more awards in accordance with existing program agreements. When a determination is made as to what base will be used to allocate costs, the following points should be considered:

- The allocation base must reasonably reflect the level of service received by all county departments benefitting from the activity;
- There must be a direct causal relationship between the allocation base used and the service provided; and
- The allocation base must be auditable and supported by information kept on file in the county.

### **Section 2470: Choosing an Allocation Base**

It is difficult to prescribe specific bases to be used in allocating central support service activities. Within the different California county organizational structures, there exists a range of acceptable allocation bases for each service activity, ranging from simple to complex. For example, the expense of cost plan preparation is considered allowable for grant reimbursement purposes. This activity benefits departments that claim or have a potential to claim reimbursement for grant programs and departments that bill other county departments, outside agencies, or the general public for services rendered. Choosing an allocation base permits the assignment of full operational costs, including overhead, to various county departments. Allocation bases selected should reflect this service relationship and could include:

- Proportionate allocation to all benefitting departments, including general fund and ISF service departments, based upon benefits identified in the cost plan base year period;
- Allocation to all benefitting departments based upon total departmental expenditures, adjusted to exclude fixed assets, flow through funds, and large contracts;
- Allocation to all central support service units, using total expenditures adjusted to exclude fixed assets, flow-through funds, and large contracts; and



- Allocation to all central support service units based upon actual time spent in each central support service department.

All of the methods of assigning the costs to prepare a cost plan constitute appropriate allocation methodologies and serve to illustrate the complexities involved in prescribing just one base to be used for allocations. What may be an appropriate allocation base for one county with a comprehensive accounting system may be too complex or cumbersome for use in a small county with limited resources to capture and categorize data. The intent of 2 CFR Part 200 is to provide a means of identifying the indirect and support service costs related to grant programs without imposing upon grantees the requirement to maintain formal cost accounting systems.

### **Section 2480: Summary**

In summary, when an allocation base is required to distribute a given service cost, a base should be selected, using statistical information, that can be compiled without prohibitive costs and that provides a direct causal relationship between the allocation method used and the expenditures allocated.

## **Section 2500: Depreciation**

Straight-line depreciation is the only acceptable method of allocating the cost of fixed assets to specific time periods in which the county benefits from the use of the assets.

### **Section 2510: Depreciation Defined**

Depreciation is used to allocate the cost of fixed assets throughout their useful life. Depreciation must be based on the actual acquisition cost of the asset and not upon its replacement value. Accelerated depreciation is not allowed; only straight-line depreciation may be used. The useful life of any asset is that established for the applicable class of assets in Internal Revenue Service guidelines for straight-line depreciation, unless a county can propose a reasonable, objective, and independently derived alternative schedule.

### **Section 2530: Depreciation Conditions**

Effective December 26, 2014, use allowance has been eliminated as a method of allocating the cost of fixed assets. Any reference to use allowance is provided for informational purposes only.

All assets of a single class must be treated in the same manner. Complete property records must support all depreciation charges. Physical inventories must be taken at least every two years. Depreciation records must show depreciation taken each period, the total amount of accumulated depreciation charged, the useful life of each fixed asset, and the remaining value of each fixed asset. Depreciation may not be claimed for a fixed asset after the total acquisition cost and the costs of any capitalized additions to the fixed asset have been fully recovered. Inventory records must identify assets purchased with federal funds. The federal government may not be charged for the use of equipment it has purchased. Depreciation is discussed in Section 3240.

### **Section 2540: Allowable Financing Costs**

Non-federal entities can be reimbursed for financing costs associated with patents and computer software acquired on or after fiscal year 2016-17 and capitalized in accordance with GAAP. Financing costs associated with otherwise allowable costs of capital assets are allowable (including interest) if paid and incurred, and if the conditions below are met:

- The financing is provided (from other than tax or user fee sources) by a bona fide third party external to the government unit.
- The assets are in support of federal awards.
- Earnings on debt service reserve funds or interest earned on costs borrowed funds pending payment of the construction or acquisition costs are used to offset the current period's cost or the capitalized interest, as appropriate. Earnings subject to being reported to the federal Internal Revenue Service under arbitrage requirements are excludable.
- Non-federal entities will negotiate the amount of allowable interest whenever cash payments (interest, depreciation, and contributions) exceed the governmental unit's cash

payments and other contributions attributable to the portion of real property used for federal awards.

## **Section 2600: Electronic Data Processing – Grant Agency Approval**

State and federal financial participation in the acquisition of electronic data processing (EDP) equipment, systems, and services specifically to grantee agencies requires prior approval of the federal grantor agency. CDSS is the cognizant grantor agency for all of the programs that it administers. Prior approval requirements for the acquisition of EDP equipment, systems, and services purchased from public/private vendors and/or consultants are found in Division 28 of the *Manual of Operations, Policies, and Procedures*, Reference CDSS Manual Letter No. 89-01, dated April 1, 1989. It is the responsibility of the county welfare department and the district attorney, family support division, to secure the required approvals through the Health and Human Services Data Center (HHSDC), Project Approval Unit, in accordance with the guidelines set forth in this section and current federal and state regulations.

EDP analysis, design, programming, or implementation efforts directed for use in the administration of public welfare programs also requires prior approval from HHSDC. The costs of these activities, if approved by HHSDC and assigned a project number, must be billed directly to the county welfare department for reimbursement purposes. The costs of all systems development services provided directly to the county welfare system or to the Child Support IV Program must be removed before being carried forward to the Summary/Exhibit of Costs. These costs are not to be included in the 2 CFR Part 200 Exhibit of Costs and claimed as overhead. Costs incurred for a system development effort that benefits more than a single department, such as payroll and activity reporting system, should be identified to the department responsible for providing the system service and distributed to all benefitting departments, funds, and agencies.

Because of the special requirements of CDSS for the reimbursement of grant department systems development costs, it is necessary for each county to identify all systems development work as a separate cost center. The costs of all systems development services provided directly to the county welfare department or Child Support IVD Program must be removed before being carried to the Summary Exhibit of Costs.

## **Section 3100: Purpose and Intent**

Building space is considered a countywide resource regardless of the method used to acquire the space (purchase, construction, lease, or rent). Accordingly, the SCO has been designated as the cognizant grantor agency responsible for the review and approval of all space costs associated with property owned or managed by the county as a whole that benefits different budgetary units within a county.

The purpose of Part III of this handbook is to summarize the rules and regulations relating to space that have evolved at both the federal and the state level, and to provide guidelines for grant reimbursement of space costs. Exhibits 3101 and 3102 provide a summary of reimbursement methods.

### **Section 3110: History and Background**

Prior to July 1, 1980, the approval to claim costs associated with space occupied by county departments was essentially divided between two grantor agency groups. Costs for space occupied by countywide service departments and non-grantee operating departments could be included in the countywide cost allocation plan for claiming. Approval of the countywide cost plan implicitly included approval of the space costs associated with these departments.

For space occupied by grantee departments and considered to be a direct cost under the grant, a separate and more restrictive set of approval procedures was used. Each federal or state grantor agency was responsible for approving the space costs associated with that agency's grant programs. Distinctions were made between county-owned space and rented/leased space. In most cases, rented/leased space required prior approval and had to be claimed as a direct cost, while county-owned space was distributed through the cost plan.

To further complicate matters, special agreements were often negotiated between the grantor agency and a county grantee department to allow for the accelerated claiming of space costs, as opposed to using normal depreciation or use allowance methods. This often resulted in confusion when grantee departments submitted claims for reimbursement of space costs. Effective December 26, 2014, use allowance was eliminated as a method of allocating the cost of fixed assets.

Responsibility for space approval was transferred by HHS to the SCO effective July 1, 1980. Since that time, information relating to the occupancy of space by county departments has been required each time a countywide cost allocation plan is submitted. However, as with all other costs approved under the principles of 2 CFR Part 200, there is one important caveat: acceptance of space costs by the SCO establishes only that those costs are approved for reimbursement under cost principles. The actual reimbursement of costs claimed is subject to the policies and availability of funds from the individual grantor agencies.

### **Section 3120: References**

Listed below are the references used in compiling the information in this part of the handbook. These publications may prove useful to anyone seeking more detailed information regarding the claiming of space costs.

- 2 CFR Part 200, Appendices IV through VIII, relate to the recovery of space costs;
- HHS ASMB C-10 addresses cost principles and procedures for developing the cost allocation plan and indirect cost rates for agreement with the federal government (see especially Sections 3-28 through 3-47);
- Internal Revenue Service Publication 946, *How to Depreciate Property*, discusses straight-line depreciation and provides property class lives and recovery periods.
- GASB Statement No. 87, *Leases*, establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset;
- GASB Statement No. 96, provides guidance on the accounting and financial reporting for subscription-based information technology arrangements (SBITAs); and
- County Fiscal Letter No. 20/21-106, issued by the California Department of Social Services, provides County Welfare Departments with updated policies and claiming instructions related to space (real property) costs.

## **Exhibit 3101: Summary of Reimbursement Methods for Capital Expenditures Facilities Owned by the County and Facilities Not Owned by the County**

### **Capital Expenditures**

Listed below are types of capital expenditures by category and applicable section of guidelines.

#### **Acquisitions**

Purchase (Section 3220)  
Construction (Section 3220)  
Donation and Surplus  
Capital Leases (Section 3330)  
Interest (Section 3220)

#### **Improvements**

Improvements (Section 3530)  
Additions (Section 3530)  
Property (Section 3230)

### **Reimbursement Methods**

1. The acquisition and capital improvement costs of facilities owned by the County are reimbursable using straight-line depreciation. (See Section 3240).
2. The cost of occupying space under a capital lease, the cost of capital improvements on such facilities, and the costs of associated interest paid or incurred are reimbursable up to amounts that would have been allowed had the county acquired ownership. (See Section 3330).
3. The cost of capital improvements on facilities occupied under capital leases is allowable for reimbursement when depreciated over the remaining life of the lease. The resulting lease cost and amortized improvement costs cannot exceed the cost of comparable space in other private sector buildings. (See Section 3530).

**Exhibit 3102: Summary of Reimbursement Methods for Ordinary Expenditures  
Facilities Owned by the County and Facilities Not Owned by the County**

Listed below are the types of ordinary expenditures and the applicable sections of the guidelines.

**Description**

Alterations and Maintenance (Section 3540)

Interest and Expense (Section 3250)

**Reimbursement Methods**

1. Normal maintenance is treated as an annual operating cost and is allocable for reimbursement in the year of expenditure.
2. Alterations and minor repairs are treated as annual operating costs and are eligible for reimbursement in the year of expenditure to the extent they are not provided for in a rental rate or lease/rental agreement. Social services agencies may claim reimbursement for expenditure amounts approved in their proposed county administrative budget (PCAB) for the year in question. If an alteration project exceeds the approved PCAB amount, then the costs should be capitalized for county-owned buildings and amortized over the remaining life of capital leases.
3. Interest paid or incurred and other financing costs associated with building acquisition may qualify for reimbursement under an interest amortization/rental rate. (See Section 3220 and 3250).



## **Section 3200: Characteristics of County-Owned/Managed Facilities**

Facilities include buildings (offices, storage, jails, museums), special use facilities (auditoriums, convention centers), parking lots, parks, airports, public works facilities (sewage, water treatment), and medical facilities (hospitals, clinics, emergency centers).

County-owned/managed facilities are facilities that are owned by the county, purchased or constructed by the county, or acquired through a capital lease, an exercise of a joint powers agreement, and/or formation of a nonprofit entity.

County-owned facilities may be acquired through many different methods, including purchase, transfer, lease-purchase, donation, construction, surplus property acquisition, and capital lease.

### **Section 3210: County-Owned/Managed Space Costs**

The costs of fixed assets may be allocated to the period benefitted using depreciation. Straight-line depreciation must be used for buildings and improvements (including land improvements such as paved parking areas, fences, and sidewalks) based on the acquisition costs plus capitalized improvements. Where a financing agreement is used to acquire a building, the interest expense may be eligible for reimbursement (See Section 3250).

### **Section 3220: Acquisition Costs**

The cost of structures and improvements includes all expenditures incurred in connection with their acquisition, including the following:

- Purchase price or construction cost;
- Accident or injury cost during construction;
- Fixtures attached;
- Payment of damages resulting from construction;
- Architects' fees;
- Insurance expenses during construction;
- Cost of permits and licenses;
- Interest expense during construction (see Section 3250); and
- Landscaping and sidewalk construction incidental to the building's construction and necessary for the use of the building.

The following costs are unallowable under cost principles and must be excluded from acquisition costs:

- Any cost, or portion of cost, of a facility borne directly or indirectly by the federal or state government; and
- The following costs associated with land: purchase price, condemnation fees, appraisal and negotiation fees, clearing land use, title search fees, demolishing or removing structures, costs of consents, and filing costs.

Acquisition costs must be reduced by:

- Amounts received for the sale of salvage from materials charged against the construction;
- Discounts, allowances, and rebates secured; and
- Amounts recovered through surrender of liability and casualty insurance.

The interest expense associated with financing a building, once the building is occupied, should not be capitalized as a part of the acquisition costs. Under specified conditions, however, this interest is eligible for reimbursement as an annual expense as a rental rate system/component (See Section 3410).

### **Section 3230: Facilities Acquired by Transfer, Donation, or Surplus Acquisition**

When assets are transferred between funds, (e.g., between an ISF and the general fund), GASB Cod. Sec. 2300.127 (Section 2300, Paragraph 127) dictates that such transactions be regarded as taking place between independent financial entities.

When examining this interfund transfer of facilities from a grant reimbursement perspective, the federal government views the entire county as one distinct governmental entity. The basis for reimbursement of a facility acquired by an operating fund and later sold or transferred to a proprietary fund is the original cost to the county, plus the actual costs of any capital improvements. Reimbursement cannot be arbitrarily increased by recording of the asset at a “fair market value” that, at the time of transfer, is greater than the cost recorded in the records of the fund transferring the property.

2 CFR Part 200, Section 200.306, states that facilities donated to the county from external sources should be recorded at their estimated fair market value on the date they are accepted by the board of supervisors. Purchases of governmental surplus property at nominal prices below market value are in part donations and should be so valued.

In many cases, the federal government will have participated in the cost of constructing a facility that is being transferred, donated, or purchased at a bargain price by a county, or reconstructed as a result of a natural disaster. As the federal government can participate in these costs in many different ways, it is difficult to develop and apply a general set of rules for valuation, and each case must be examined on its own merits. To determine an appropriate acquisition cost for grant

reimbursement purposes, the SCO County Cost Plans Unit should be provided with complete details of the transaction.

### **Section 3240: Depreciation**

Depreciation is the method for allocating the cost of fixed assets to periods benefitting from asset use. Effective the fiscal year after December 26, 2014, use allowance is no longer available as a substitution for depreciation.

2 CFR Part 200, Section 200.436, provides that the non-federal entity may be compensated for the use of its buildings, capital improvements, equipment, and software projects capitalized in accordance with GAAP, provided that they are used, needed in the non-federal entity's activities, and properly allocated to federal awards. Such compensation must be made by computing depreciation.

Depreciation is computed applying the following rules:

- The computation is based on capitalized costs, as defined in Section 3530, and supported by actual cost records as defined in Section 3550. If actual cost records have not been maintained or cannot be reconstructed for a particular facility, a reasonable estimate of the total acquisition costs may be used. All such estimates must be entered into, and reflected on, the county's accounting records for future authenticity. The SCO must be contacted regarding the procedures for determining estimated acquisition cost.
- Physical inventories of all fixed assets must be performed at least every two years to ensure that assets on which depreciation has been taken exists and are in use. The inventory records and any associated depreciation records must be available for review with all other records that support the cost plan.
- Records maintained on county buildings must include a listing of the occupant(s) of each building and report the square footage used by each occupant of any building that has more than a single occupant.
- Adequate property records must be maintained. These records include depreciation schedules for each facility. The schedules may be part of a formal accounting system or may be supplements to the countywide cost allocation plan.

Straight-line depreciation is the only acceptable method that may be used to allocate the costs of county fixed assets over their useful life unless the county is able to present clear and convincing proof that the expected consumption of an asset will be considerably greater in the earlier portion rather than the later portion of its useful life. Useful life should be based on a useful life study for the facility including such factors as site location, type of construction, and utility to the county given a normal schedule of maintenance but without major renovation.

Once implemented, depreciation methods may not be changed unless the change is approved by the SCO, as the cognizant agency. 2 CFR Part 200, Section 200.436 (d) (5) states that where the depreciation method is introduced to replace the use allowance method, depreciation must be

computed as if the asset had been depreciated over its entire life (i.e. from the date the asset was acquired and ready for use to the date of disposal or withdrawal from service). The total amount of use allowance and depreciation for an asset (including imputed depreciation applicable to periods prior to the conversion from the use allowance method, as well as, depreciation after the conversion) may not exceed the total acquisition cost of the asset.

The county must choose the depreciation method for a single class of asset (e.g., general-purpose office structures). As defined in Exhibit 3501, Space Terminology, the single class of assets for buildings in a county is broadly defined as all buildings, including any appurtenant structures or improvements in connection with these buildings.

Special use facilities, (e.g., waste or water treatment plants or parks) may be considered a separate class of assets for the purposes of implementing this section.

Depreciation on fixed assets that are considered excess or idle, or for facilities that are *not* occupied, may not be charged against grant programs without specific authorization from the grantor agency. Questions regarding this topic should be addressed to the SCO County Cost Plans Unit.

Any claim for reimbursement that will result in cost recovery that exceeds actual cost is unreasonable and unallowable and no further depreciation may be claimed. Requests for exceptions to this policy must be fully documented and submitted to the SCO County Cost Plans Unit for specific approval (See ASMB C-10, Part 3, Section 3-34).

Revenue received in connection with activities associated with a facility, such as rented space, parking fees, or vendor stands will be treated under the applicable credit rule of 2 CFR Part 200, Section 200.406 [see handbook Section 2210 Allowable Income (Revenue)].

All county owned/managed space costs claimed through depreciation must be claimed through the countywide cost allocation plan.

### **Section 3250: Interest Expense**

Under 2 CFR Part 200, Section 200.449, financing costs (including interest) incurred or paid on or after September 1, 1995, associated with the otherwise allowable costs of building acquisition, construction, fabrication, reconstruction, or remodeling completed on or after October 1980 are allowable. This section also allows financing costs (including interest) incurred or paid after September 1, 1995, associated with otherwise allowable costs of equipment. The actual interest expense either paid or accrued by a county may be claimed for reimbursement through the use of an interest amortization/rental rate system based on actual costs. Interest amortization is discussed in Section 3400.

Effective December 26, 2014, for non-federal entity fiscal years beginning on or after January 1, 2016, intangible assets include patents and computer software. For software development projects, only interest attributable to the portion of the project costs capitalized in accordance with GAAP is allowable.

The condition placed upon the allowability of interest costs for a publicly owned building is that it must be newly occupied on or after October 1, 1980. Following are examples:

- Non-grantee department, prior to October 1, 1980, occupies a county-owned building. Subsequent to that date, the building is vacated and reoccupied by grantee departments. Interest costs are not eligible as a rental rate component, as the building was occupied prior to October 1, 1980.
- A county-owned building is acquired prior to October 1, 1980, but remains unoccupied until after that date. Interest costs are an allowable component in the rental rate, as the building was newly occupied on or after October 1, 1980.
- A rented (non-county) building is occupied by a grantee department prior to October 1, 1980. Subsequent to that date, the county purchases the building, making it county-owned. Even though the building was occupied prior to October 1, 1980, it did not meet the test of publicly owned because it was rented. Therefore, interest costs are an allowable component in the rental rate, as the building became a publicly owned facility, and was newly occupied as such after October 1, 1980.

Reimbursement may be claimed for interest costs incurred on a building acquired under a lease required to be treated as a capital lease under governmental generally accepted accounting principles, a sale and leaseback arrangement, or a less-than-arms-length lease agreement in accordance with 2 CFR Part 200, Section 200.465.

In the case of capital leases, the lease is treated as an installment purchase of the property. As installment purchases invariably require the payment of interest, an imputed interest expense would be allowable under this type of lease. The amount of interest expense should be determined from the information in the lease agreement and/or information obtained from the lesser. If this is not possible, the interest expense should be based on the interest rate charged to the county in similar borrowing arrangements (at the time of the lease execution).

Rental costs under sale and leaseback arrangements are allowable only up to the amount that would be allowed had the governmental unit continued to own the property.

Under a less-than-arms-length lease, the property is treated as though the lessee instead of the lessor had purchased it. If the lessor incurs an interest expense in purchasing the property, then this expense would be considered as an expense of the lessee and would be allowable.

If a building qualifies under 2 CFR Part 200, Section 200.449, the interest expense incurred during the construction of the building (or other period needed to get the building ready for use) is an allowable component of the total capitalized cost of the building. This interest expense, along with other capitalized costs of the building, should be claimed as a component of depreciation if the building was newly occupied on or after October 1, 1980.

Interest costs incurred or paid for the acquisition of land acquired in connection with the acquisition of a building after June 30, 1996, are allowable. Interest on the acquisition of land by itself is not allowable. Principal payments for the acquisition of land are unallowable.

When part of the financing costs of a building is charged to the federal government, either directly or through the cost plan, the federal government must also participate in any income earned by the county that is related to that financing. If a county finances a building by issuing bonds and sets up a sinking fund to retire the bonds, the income earned by the sinking fund must be offset against the interest expense. Interest amortization and rental rate computations are discussed in Section 3400.

## **Section 3300: Characteristics of County-Owned/Managed Leases**

### **County-Owned/Managed Defined**

Space costs associated with property owned or managed by the county as a whole that benefits different budgetary units within a county should be included in a county's CCAP. Under the requirements of 2 CFR 200 and Governmental Accounting Standards Board Statement 87 (GASB 87), this space includes buildings that are owned by the county; purchased or constructed by the county; or occupied/acquired by the county through lease (other than short-term lease), a joint exercise of powers agreement, and/or the formation of a non-profit entity (i.e., any agreement that conveys control of the space to the county as a whole, including less-than-arms-length agreements described in this letter).

### **County Welfare Departments (CWD)-Owned/Managed Defined**

CWD-owned/managed space is property owned or managed by only the CWD and is not owned/managed by the county as a whole. If an asset is leased/purchased exclusively on behalf of the CWD by the county and does not benefit other departments/budgetary units besides those associated with the CWD, it should be considered CWD-owned/managed space.

If a CWD is, together with other tenant county departments, leasing a portion of a building owned by the county as a whole, it would be considered a county-owned/managed space and should be included in the county CCAP.

### **Section 3310: County-Owned/Managed Space Costs**

Under federal regulations found in 2 CFR 200.465, leases (also referred to as rental agreements) have been divided into two categories: leases that are required to be treated as capital leases by Generally Accepted Accounting Principles (GAAP) and those that are not. If considered to be a capital lease, the lease's costs would be depreciated in a manner similar to other capital assets.

2 CFR Part 200, Section 200.465, states that rental costs are allowable to the extent that the rates are reasonable in light of such factors as: rental costs of comparable property, if any; market conditions in the area; alternatives available; and the type, life expectancy, condition, and value of the property leased. Rental arrangements should be reviewed periodically to determine if circumstances have changed and other options are available.

There are many different types of leasing arrangements, including the following:

- Monthly rental;
- Annual rental/lease;
- Lease with option to purchase;
- Capital leases/lease purchases;

- Sale-and-leaseback arrangements;
- Less-than-arms-length lease; and
- Rental or lease payments are allowable under lease contracts where the non-Federal entity is required to recognize an intangible right-to-use lease asset (per GASB) for purposes of financial reporting in accordance with GAAP.

**Section 3320: Reimbursement Methods – Leases**

**Erratum to County Fiscal Letter 20/21-106**

California Department of Social Services (CDSS) issued a revised policy letter on June 26, 2023, to provide County Welfare Departments with specific guidance related to the implementation of GASB 87, and updated policies and reimbursement instructions related to space (real property) costs. Since GASB 87 standards are the basis for SBITA standards, CFL 20/21-106E guidance is applicable to the implementation of GASB 96 even though it was designed for the implementation of GASB 87. Below is information obtained directly from page four of the erratum:

Several tables summarizing and comparing the state of the guidance related to lease cost accounting and claiming at the time CFL 20/21-106 was released versus the changes that have been made via this erratum have been provided below...

Guidance contained in <a href="#">CFL 20/21-106</a> as originally released:			
Activity	Short Term	RTU	Financed Purchase
Accounting	Cash	<a href="#">GASB No. 87</a> Amortization	<a href="#">GASB No. 87</a> Amortization
Claiming	Cash	<a href="#">GASB No. 87</a> Amortization	<a href="#">GASB No. 87</a> Amortization
Guidance as implemented by this erratum:			
Activity	Short Term	RTU	Financed Purchase
Accounting	Cash	<a href="#">GASB No. 87</a> Amortization	<a href="#">GASB No. 87</a> Amortization
Claiming	Cash	Cash	Financed Purchase Depreciation

The erratum CFL 20/21-106 issued on June 26, 2023 is available at [County Fiscal Letters - Policy/Claiming](#)

**Section 3335: Sale and Leaseback**

Under a sale-and-leaseback arrangement, property owned by an organization is sold to and leased from another organization or individual. The property sold and any related liabilities are eliminated from the seller-lessee’s accounting records and a gain or loss on the sale portion of the sale-leaseback is recognized by the seller-lessee.



**Section 3340: Allowability of Leases**

**Impact of Governmental Accounting Standards Board Statement 87 (GASB 87) and Governmental Accounting Standards Board Statement 96 (GASB 96) on the Allowability of Leases in Countywide Cost Allocation Plans:**

Since GASB 87 and 96 went into effect, the County has been required to recognize and amortize intangible right-to-use (RTU) lease assets for qualified leases and subscription-based information technology arrangements (SBITA). While the recognition of these RTU lease assets are required for financial reporting purposes, amortization expense for qualified leases and SBITA are not allowable in the Countywide Cost Allocation Plans (CCAP) based on federal regulations and [County Fiscal Letter \(CFL\) 20/21-106E](#). Particularly, intangible right-to-use assets are excluded from the definition of capital assets under [2 Code of Federal Regulations 200.1 "Capital assets" paragraph \(2\)](#). Therefore, the SBITA (initial implementation costs plus the subscription asset itself) amortization expense and qualified lease amortization expense should not be included in the CCAP. Although CFL 20/21-106E guidance was intended for the implementation of GASB 87, it is applicable to the implementation of GASB 96, as GASB 87 standards serve as the foundation for SBITA standards.

The table below shows the similarities between GASB 87 and GASB 96. GASB 96 is an accounting standard for SBITA, while GASB 87 is an accounting standard for leases.

GASB Statement 87	GASB Statement 96
<p><a href="#">GASB Statement 87</a>, effective for reporting periods beginning after December 15, 2019, provides guidance on the accounting and financial reporting for leases. GASB 87 defines and establishes that:</p>	<p><a href="#">GASB Statement 96</a>, based on the standards established in GASB Statement 87, effective for fiscal year beginning after June 15, 2022, provides guidance on the accounting and financial reporting for SBITA. GASB 96 defines and establishes that:</p>
<ol style="list-style-type: none"> <li>1.) A lease is defined as a contract that conveys control of the right to use another entity’s nonfinancial asset (the underlying asset) as specified in the contract for a period of time in an exchange or exchange-like transaction.</li> <li>2.) At the commencement of the lease term, a lessee should recognize a lease liability and an intangible right-to-use lease asset (a capital asset).</li> </ol>	<ol style="list-style-type: none"> <li>1.) SBITA is a contract that conveys control of the right to use another party’s information technology software, alone or in combination with tangible capital assets (the underlying IT assets), as specified in the contract for a period of time in an exchange transaction.</li> <li>2.) SBITA results in an intangible right-to-use asset and a corresponding subscription liability. As such, a subscription asset should be amortized in a systematic and rational manner over the shorter of the subscription term or the useful life of the underlying IT assets.</li> </ol>

GASB Statement 87	GASB Statement 96
3.) The lessee should amortize the lease asset in a systematic and rational manner over the shorter of the lease term or the useful life of the underlying asset.	3.) Activities associated with SBITA are grouped into different stages with their costs accounted for accordingly. GASB 96 states that costs associated with the Initial Implementation Stage generally should be capitalized in addition to the subscription asset.

Reimbursement for leases are available as follows:

- According to [2 CFR 200.465\(b\)](#), rental costs under “sale and lease back” leases are allowable only up to the amount that would be allowed had the non-federal entity continued to own the property. This amount would include expenses such as depreciation, maintenance, taxes, and insurance.
- According to [2 CFR 200.465\(c\)](#), rental costs under “less-than-arm’s-length” leases are allowable only up to the amount of what would be allowed if the lessee owned the property. This amount would include expenses such as depreciation, maintenance, taxes, and insurance. For this purpose, a less-than-arms-length lease is defined as a lease under which one party to the lease agreement is able to control or substantially influence the actions of the other. Such leases include but are not limited to:
  - Divisions of the non-federal entity;
  - The non-federal entity under common control through common officers, directors, or members;
  - The non-federal entity and a director, trustee, officer, or key employee of the non-federal entity, or an immediate family member, either directly or through corporations, trusts or similar arrangements in which they hold a controlling interest; or
  - Family members, as defined in regulation.
- According to [2 CFR 200.465\(d\)](#), rental costs under leases which are required to be treated as financed purchases under GAAP are allowed only up to the amount that would be allowed had the non-federal entity purchased the property on the date the lease agreement was executed (an amount that would include expenses such as depreciation, maintenance, taxes, and insurance).

## **Section 3400: Interest**

Interest expenses incurred or paid after building occupancy for the acquisition of construction of a building may be expensed over the life of the financing instrument. Allowable interest may be expensed as it is paid or amortized, or it may be expensed on a straight-line basis. The method by which such amortization has been effected has been referred to as a “rental rate system.” Interest amortization may be accomplished by any acceptable system that results in charges based on actual costs regardless of whether the costs are treated as direct or indirect costs and regardless of whether the costs are billed to user departments or are allocated through a cost allocation plan. Any costs included in an interest amortization/rental rate schedule may not be charged or allocated elsewhere. Exhibit 3401 provides a comprehensive example of a rental rate system computation.

### **Section 3410: Rental Rate Components**

Interest expenses incurred or paid after building occupancy for the acquisition of construction of a building may be expensed over the life of the financing instrument. Interest expense must be computed on amounts actually paid or incurred for building purchase or construction. A rental rate system is defined as any acceptable costing system that results in charges based on actual costs, regardless of whether the costs are treated as direct or indirect costs and regardless of whether the costs are billed to user departments or are allocated through a cost allocation plan. Any costs included in a rental rate computation may not be charged or allocated elsewhere.

### **Section 3420: Rental Rate Charges**

Depreciation expense may be included in the rate computations for building cost. The acquisition costs or construction costs must be fully supported.

The following elements can be included in rental rate charges when they are based on costs that were actually incurred or paid:

- For costs to be allowable, the non-Federal entity must have incurred the interest costs for buildings after October 1, 1980, or for land and equipment after September 1, 1995. The actual interest paid or incurred by the county on a purchase contract or capitalized construction costs less any interest credits, where applicable, may be included in the rental rate charges.
- Interest paid for the acquisition of land when the land was acquired in connection with the acquisition of a building after July 1, 1996, is allowable per ASMB C-10, Section 3-43.
- Interest payable over the life of the financing agreement must be supported by an interest amortization schedule.
- The issuance cost of a bond, which consists of professional fees, selling commissions, printing costs, etc., should be identified on the statement that presents the details of the proceeds of issuance. Issue costs may be amortized over the term of the financing

agreement on a straight-line basis and included as a component of rental rate computations.

- Any premium or discount on the financing instrument is identified on the statement that shows the breakdown of proceeds of the issuance. A premium or discount may be amortized over the term of the financing agreement on a straight-line basis and included as a component of the rental rate computation.
- Bond reserves can be included in a financing instrument for unforeseen or underestimated costs. These reserves are identified on the statement that presents the details of issuance proceeds. Only that portion of the contingency that is actually expended toward the facility may be amortized over the term of the financing agreement on a straight-line basis and included as a component of the rental rate computations.

Recurring costs of servicing a building, such as maintenance fees/expenses, related administrative costs, taxes, and insurance, are allowable and may be charged directly to benefitting departments or allocated to these departments through the cost plan. If not included in the rental rate, these costs can be included in the countywide cost plan for further allocation to the occupying departments.

The bond reserve portion of the proceeds from a bond sale is retained by the institution that is designated as trustee for the lender. This fund is to be used for payment of principle and interest should the county be unable to make a payment. Any unused portion of the reserve fund will be used to make the final payments on the debt. In either case, the bond reserve is used to make principal and interest payments and represents a source of loan repayment. The reserve fund and its prorated share of interest expense are not eligible for inclusion in the rental rate computation for reimbursement purposes.

### **Section 3430: Approval Requirements for Rental Rates**

Costs claimed on the basis of rental rate systems that included interest and financing charges no longer require prior approval from the SCO. However, all counties must maintain complete, comprehensive cost information on file supporting rental rates for buildings used by central support and grant departments. All rental rates claimed in countywide cost plans must be fully described in the narrative that prefaces the space or building use section of the cost plan.

Rental rates and the associated costs of new buildings occupied by central support and grant departments are examined during the SCO's cost plan analyst reviews. These reviews include verification that all capitalized expenditures are fully supported and accurately reflect the costs of procuring or purchasing buildings and preparing them for occupancy, that these costs have been correctly capitalized, that recovery of these capitalized costs is in accordance with 2 CFR Part 200, and that all cost amortization schedules are correct.

Counties may expense or amortize interest, as they prefer, for the acquisition of buildings and related land, construction or fabrication, reconstruction, or remodeling subject to the criteria, as stated in 2 CFR Part 200, Section 200.449, and ASMB C-10, Section 3-43.

Once a rental rate schedule has been used to assign building costs in a countywide cost allocation plan, the same schedule must be consistently used for the life of the associated building, unless the SCO determines that the rental charges should be modified or abolished. Costs based on estimated rental rates may be billed to the occupants of the associated buildings but these estimated charges must be adjusted to actual costs, based on finalized rental rates presented in the countywide cost plan.

### Exhibit 3401: Comprehensive Rental Rate Computations

The following chart is an example of a comprehensive rental rate computation for a county welfare department. In this example, the county purchased a 20,000-square-foot building for use as the department's main office. The building was financed by the issuance of 20-year bonds. This example demonstrates how the costs of the building, bond issue components, and interest expense are included as rental rate charges. The cost of land is unallowable under the cost principles; however, interest paid on the acquisition of land is allowable. The bond reserve component is not a cost to the county and, therefore, it is not included in the rental rate. Interest expense related to the bond reserve is also excluded.

<b>Acquisition Cost</b>			
Building and Architect Expenses	1,113,854	91.01%	Allowable
Land	110,000	8.99%	Unallowable
<b>Total Acquisition Costs</b>	<b>1,223,854</b>	<b>100.00%</b>	
<b>Straight Line Depreciation:</b>			
Building Costs and Architect Expenses		1,113,854	
		÷	30 years (*)
<b>Allowable annual straight line depreciation claimable amount</b>			<b>37,128</b>
(*) - Please refer to your county's depreciation policy for building depreciation.			

### Computation of Annual Allowable Costs and Percentage Factors (Example)

Proceeds of Bond Issue:

	<b>Total</b>	<b>Allowable</b>	<b>Unallowable</b>
Building Cost	1,095,319	1,095,319	
Architect Expenses	18,535	18,535	
<b>Total Building Costs</b>	<b>1,113,854</b>	<b>1,113,854</b>	
Bond Discount	45,771	41,656	4,115
<b>Bond Issue Costs:</b>			
Attorney Fees	26,118		
Bond Printing Fees	3,592		
Financial Consulting	36,382		
Bank Trustee Fees	6,919		
<b>Total Bond Costs</b>	<b>73,011</b>	<b>66,447</b>	<b>6,564</b>
Land Cost	110,000		110,000
Bond Reserve Fund	172,390		172,390
Other	19,974		19,974
<b>Total Proceeds of Bond Issue</b>	<b>\$1,535,000</b>	<b>\$1,221,957</b>	<b>\$313,043</b>

The discount and issue costs are distributed to the Allowable and the Unallowable columns using the percentages that building costs and land costs constitute of total building and land costs (91.01% and 8.99%). The allowable portions of the discount costs and issue costs will be recovered on a straight-line basis over the 20-year term of the bonds;  $(\$41,656 + \$66,447)/20$  years = \$5,405 per year.

Year	Annual Interest <sup>1</sup>	Depreciation	Amortized Discount and Issue Costs	Claimable Costs <sup>2</sup>	Monthly Claimable Costs	\$ Cost per Sq. Foot <sup>3</sup>
1	\$135,485	\$37,128	\$5,405	\$178,018	\$14,835	\$8.90
2	133,295	37,128	5,405	175,828	14,652	8.79
3	130,740	37,128	5,405	173,273	14,439	8.66
4	128,185	37,128	5,405	170,718	14,227	8.54
5	125,265	37,128	5,405	167,798	13,983	8.39
6	121,890	37,128	5,405	164,423	13,702	8.22
7	118,403	37,128	5,405	160,936	13,411	8.05
8	114,403	37,128	5,405	156,936	13,078	7.85
9	109,865	37,128	5,405	152,398	12,700	7.62
10	104,765	37,128	5,405	147,298	12,275	7.36
11	99,110	37,128	5,405	141,643	11,804	7.08
12	92,880	37,128	5,405	135,413	11,284	6.77
13	86,130	37,128	5,405	128,663	10,722	6.43
14	78,395	37,128	5,405	120,928	10,077	6.05
15	70,115	37,128	5,405	112,648	9,387	5.63
16	60,915	37,128	5,405	103,448	8,621	5.17
17	50,685	37,128	5,405	93,218	7,768	4.66
18	39,525	37,128	5,405	82,058	6,838	4.10
19	27,435	37,128	5,405	69,968	5,831	3.50
20	14,414	37,128	5,405	56,948	4,746	2.85
Total	\$1,841,900		\$108,100	\$2,692,561		
21-30	0	37,128	0	37,128	3,094	1.86

<sup>1</sup> This example assumes a debt that is incurred at the beginning of the first fiscal year. In cases where debt is incurred at some other point of the fiscal year, interest and amortized costs would have to be prorated for the first and final year of the debt financing.

Building interest is allowable for county-owned facilities occupied on or after October 1, 1980.

Interest paid after July 1, 1996, for the acquisition of land is allowable per ASMB C-10, Section 3-43.

Allowable interest costs may be computed as incurred or straight line  $(\$1,841,900/20 = \$92,095)$ .

<sup>2</sup> Total costs that may be claimed for the year are the sum of the allowable interest costs, the amortized allowable bond discount and issue costs, and depreciation on the total cost of the building.

<sup>3</sup> In this example, the total useable square feet occupied by all of the residents of the building is assumed to be 20,000 square feet. The costs per square foot may be used to distribute total yearly building costs to each occupant of the building.

## **Section 3500: Space Costs Approval**

Approval of the countywide cost plan incorporates approval for grant reimbursement purposes of all space costs that are included in the cost plan.

Per CFL No. 20/21-106, page 6:

Space costs are usually incurred in connection with the occupancy of a building (also referred to as a facility) by CWD personnel. They can be costs associated with acquiring or improving the building, or costs associated with building maintenance. The costs must be reasonable, necessary, and allocable to the appropriate programs/entities benefiting from occupancy in the building. The occupied building is usually considered to be either a capital asset (whose costs are subject to depreciation) or a leased/rented facility (the costs of which, depending on the nature of the lease, may or may not be subject to amortization).

The sections of this handbook that follow address areas of space costs reimbursement methods.

### **Section 3510: Grantor Agency Special Agreements**

If a county has received past approval from a grantor agency to claim space costs under a negotiated special agreement, then the county must continue to claim in accordance with that agreement until it expires, or until the conditions set forth in the agreement change. At this time, the SCO should be contacted for further instructions.

### **Section 3520: Capitalized Improvement Costs**

2 CFR Part 200, Sections 200.1, and 200.439 define capital expenditures incurred on fixed assets after their original acquisition:

- Capital expenditures means expenditures to acquire capital assets or expenditures to make additions, improvements, modifications, replacements, rearrangements, reinstallations, renovations, or alterations to capital assets that materially increase their value or useful life. The cost of capitalized expenditures should be added to the book value of the asset where the original cost of a component being improved can be specifically identified. This original amount should be written off and the new cost capitalized. Capitalized expenditures are, on occasion, referred to as betterments. The decision as to whether an expenditure should be capitalized shall be made by an evaluation of engineering, physical, or other relevant factors apart from cost.
- Additions are new and separate units or extensions of existing units and are considered to be capital assets. As with betterments, the test of significance should be applied. Additions and improvements to infrastructure assets should be capitalized.

Costs associated with capitalized improvements for facilities owned by the County, or with facilities acquired under a capital lease, are allowable for reimbursement with capitalized expenditures and claimed through normal depreciation in the countywide cost allocation plan.



No prior approval is required for reimbursement. Counties that routinely compute annual depreciation for all facilities owned by the County must depreciate the cost of any capital improvements over the remaining useful life of the building if a capital improvement appreciably extends the useful life of the building, the extended period should be used.

The costs associated with capital improvements on facilities occupied under a capital lease should be depreciated over the remaining period of the lease. The resulting monthly lease cost plus amortized improvement costs must not exceed the rental costs of comparable space in a privately owned facility. The county must obtain new documentation on comparable rental rates to ensure that the total costs claimed for the improved leased building do not exceed the costs of space in privately owned buildings.

No prior approval is required for reimbursement, but new capital improvements should be disclosed and described in the narrative for the space schedule. Future field reviews and/or audits will determine whether improvements were both necessary and reasonable.

Capital improvements costs on capital leases may be claimed as direct costs only if paid directly from a grant recipient's budget or billed to the grantee. Otherwise, they must be claimed through the countywide cost allocation plan. If billed, they must be adjusted to actual in the plan.

When making capital improvements to a facility occupied under a capital lease, the county must ensure that the improvement is both necessary and reasonable for the proper and efficient administration of the grant program because of the limited period available for the use and benefit of the improvement.

### **Section 3530: Alteration and Maintenance**

2 CFR Part 200, Sections 200.452 and the [Accounting Standards and Procedures for Counties](#) define alterations and maintenance as follows:

- Maintenance is defined as expenditures that neither materially add to the value of property nor appreciably prolong its life, but merely keep it in an ordinary efficient operating condition. Maintenance costs shall not be capitalized; and
- Alterations are changes in the physical structure or arrangement of fixed assets that do not qualify as an increase in fixed asset value under the preceding definitions of betterments and additions. Alterations shall not be capitalized.

Normal maintenance costs on county-owned or rented facilities are allowable for reimbursement in the year of expenditure to the extent that they are not otherwise included in rent or other charges for space. Maintenance costs may be claimed through the countywide cost plan, or as direct costs if billed or paid directly from the grantee's budget. No prior approval is required for reimbursement of maintenance costs.

Alteration costs on county-owned or rented facilities that will benefit the operation of a grant program must be coordinated with the cognizant agency for that grant. Alteration and

maintenance costs that are not classified as capital improvements may be claimed through the countywide cost allocation plan.

If an alteration or a maintenance project substantially increases the capacity, value, operating efficiency, or useful life of an asset, then the associated costs must be capitalized and recovered through depreciation.

Comparable rents must be obtained and the rate for the facility under consideration must be within the range of these rates, taking into consideration such factors as market conditions in the area; alternatives available; and the type, life expectancy, condition, and value of the property. This condition also applies to the renewal of existing capital leases or increased costs due to leasehold improvements.

A comparable rental rate is the rate that would be charged for a non-county- owned building or parking lot that would suit the intended purposes if occupied by the county. The comparable building should be in a location suitable to the grantee program and be similar in size (square footage), construction, and cost per square foot (including maintenance, utilities, and any applicable taxes). The existence of a single rent that is significantly higher than others in the same locality would not have a bearing on the claiming, as it should be treated as an aberration and excluded from the comparable rent study.

Comparable rental rates are required for cost comparison purposes only, and the facilities do not need to be vacant. The comparison is to be retained in county files for those buildings rented/leased after January 1, 1979, and is to adhere to the following rules:

- Counties must obtain three comparable rates for privately owned space in the same general locality. The following information must be obtained for each comparable address: monthly rent amount, cost per square foot/or per parking space, whether services are included in the rate, and the number of parking spaces available.
- If the county states that there are no comparable facilities, it should obtain an estimate of rental rates by a certified real estate appraiser.
- The cost per square foot of a building, including maintenance, utilities, alterations, taxes, etc., may not materially exceed the cost of the highest comparable in order for the cost to be appropriate for state/federal financial participation.

### **Section 3540: Cost Plan Requirements for Claiming Space Costs**

In order for cost plan approvals to be processed on a timely basis, the following information must be submitted annually, either as part of the cost plan or as a supplement submitted with the cost plan:

- A narrative of the methods and procedures used to determine and distribute all space costs being claimed for reimbursement, whether direct billed, allocated, or claimed as a direct expense or negotiated cost.

- A cost summary schedule for all space costs associated with county-owned buildings or capital leases allocated through the cost plan, using depreciation or a negotiated special agreement.
- A cost summary schedule for all space costs associated with rented space where the rents are paid by a central budget unit and then billed or allocated to the occupying departments. The allocations of allowable rent must be offset by all rent billed to the occupants. Allowable rent includes rental payments on a capital lease facility.

Detail schedules supporting the summary schedules required by the second and third bullets above must be on file and available for review in the county.

When rent is paid directly from a grant recipient's budget unit and claimed as a direct cost, supplemental information listing any special claiming agreements negotiated with grantor agencies, including expiration dates and descriptions of the method used for claiming (cost plan allocation or direct cost) must be available for review.

### **Section 3550: Inquiry Information**

If the need arises for a non-federal entity to submit information concerning the acquisition or alteration of a building, the following topics should be addressed.

#### **Current Facility**

Background:

- Address, size, and type of construction.
- Date, cost, and method of acquisition by county.
  - Procedures used to claim reimbursement for the acquisition costs.
  - Grant recipient's date of occupancy and share of space occupied.
  - Identification of other departments also occupying space in this facility.
  - Estimate of the remaining useful life of the facility, given a normal maintenance and repair schedule.

Date, cost, and types of past improvements to the facility:

- Method of payment for and procedures to claim reimbursement of the costs of improvements.
- Grantee's share of improvement costs.
- Estimate of the remaining useful life of the improvements.

Supporting information:

- Copies of the lease agreement where the facility is leased, rented, or acquired under a lease-purchase agreement.
- Copies of any special claiming agreements issued by CDSS (previously Benefit Payments) for reimbursement purposes.

**Project Proposal: Alteration of Existing Facility or Acquisition of New Facility**

- Description of the project, including start and completion dates, and an estimate of total cost.
- Identification and description of project costs in the following areas:
  - Minor renovations and alterations of existing space, where applicable.
  - Major renovation of existing space and additions of new space, where applicable.
  - Modifications and additions to existing utilities required as a result of the addition.
  - Parking lot and landscaping costs associated with the project.
  - Acquisition/construction costs or lease costs of a new facility.
- Copies of any schematic drawings that will be useful in understanding the scope of the project.
- An estimate of the useful life of the improvements on the new facility.
- When the proposal entails altering an existing facility, an estimate of how many more years the grantee departments will be able to use this facility after completion of the proposed project.
- The proposed method of funding the cost of the project, independent of the reimbursement available from the State.
- Copies of three current comparable rental rates for private space in the same general area.

**Section 3560: Summary of Space Approval Requirements**

Approval of the countywide cost plan by the SCO incorporates approval for grant reimbursement purposes of all space costs that are included in the cost plan. Prior approval for the acquisition of a new facility through purchase, construction, or a capital lease that is to be claimed through

depreciation is not required. Notification to the SCO of a pending acquisition will help to avoid a delay in cost plan approval or revision to a prepared cost plan.

Prior approval by the SCO is not required to claim reimbursement for the costs of a capital lease. However, the costs must be within comparable rental rates.

- Approval from the reimbursing grantor agency is required prior to claiming when computing depreciation on idle or excess facilities for a period of non-occupancy by a grantee department, or facilities considered fully depreciated.
- Approval prior to claiming is required from the SCO when the county intends to claim the lease payments of a lease-purchase or a lease-with-option-to-purchase/renew agreement that the county interprets as a capital lease.

Any questions regarding space approval or related subjects should be addressed to [LGPSDCountyCostPlans@sco.ca.gov](mailto:LGPSDCountyCostPlans@sco.ca.gov)

## Exhibit 3501: Space Terminology

The following terms are used in the grant reimbursement process.

<u>Key Terms</u>	<u>Definition</u>
Abatement	A refund of the unearned portion of federal or state participation or equity in the cost of a building on which claiming has been accelerated faster than normally allowed under depreciation. The amount of abatement can be the amount of participation less the earned used allowance or depreciation, whichever is applicable. Or, the abatement can represent a return in equity in the facility.
Acquisition Cost	The actual cost of the building, exclusive of the cost or any portion of the cost of the building donated or borne directly or indirectly by the federal government or through charges to federal grant programs or otherwise irrespective of where title was originally vested or where it presently resides. In addition, acquisition cost excludes the cost of land and interest. Where actual cost records have not been maintained, a reasonable estimate of the original acquisition cost may be used in the computation.
Additions	Additions are new and separate units or extensions of existing units to increase square footage. The entire cost of an addition is treated as a fixed asset where a significant betterment or capitalized expenditure has occurred.
Alteration	Changes in the physical structure or arrangement of a facility (fixed asset), the cost of which does not qualify as an increase in fixed asset value under the definitions of betterments and additions. Alteration costs may not be capitalized.
Betterment	Replacement of a unit of an existing structure by an improved or superior unit, resulting in a more productive, efficient, or longer-lived property. Significant betterments are added to the value of the property improved.
Cognizant Agency	The agency having the responsibility and authority to review, negotiate, and approve the procedures and costs for grant reimbursement. The SCO has been designated by HHS as cognizant agency for space costs reimbursement.
County-Owned/Managed Space	The space costs associated with property owned or managed by the County as a whole that benefits different budgetary units within a county.

<u>Key Terms</u>	<u>Definition</u>
County Welfare Department (CWD)- Owned/Managed Space	The space costs associated with property owned or managed by only the CWD or if an asset is leased/purchased exclusively on behalf of the CWD by the county and does not benefit other departments/budgetary units besides those associated with the CWD.
Depreciation	Depreciation is used to allocate the costs of fixed assets throughout their useful life. The basis of accounting for depreciable fixed assets is capitalized costs, including all of the normal expenditures required to prepare these assets for use. All fixed asset costs must be fully supported by property records. The useful life of any fixed asset will be that established for the applicable class of fixed assets in the Internal Revenue Service guidelines for straight-line depreciation. 2 CFR Part 200 states, “In the absence of clear evidence indicating that the expected consumption of the asset will be greater in the early portions than in the later portions of its useful life, the straight line method of depreciation will be used.” ASMB C-10 adds, “The straight line procedure is presumed to be the only acceptable method because it is extremely difficult to demonstrate that the expected consumption of an asset will be significantly greater in earlier portions of its useful life.”
Donated Facilities	Facilities donated to the county. They should be recorded at their fair market value as of the date of the gift. Facilities designated as surplus property of another governmental entity and purchased by the county at nominal prices far below the facility’s fair market value are in part donations and should be valued as such.
Fixed Assets	Tangible assets of significant value having a utility that extends beyond the year of acquisition.
Fixtures	Permanent attachments to structures. Fixtures are not intended to be removed; they function as part of the structure.
Fully Depreciated Facility	Any facility whose useful life has exceeded its depreciable life, as measured from the date of acquisition (or alteration). Full depreciation applies to facilities whose total actual cost has been recovered through the application of depreciation expense.
Grant Agency	The ultimate user of grant funds. Examples include the county in general or a specific county department, such as Welfare.
Grantor Agency	The state or federal agencies that are the ultimate source of grant funds. HHS is an example.

<u>Key Terms</u>	<u>Definition</u>
Idle Facility	An unoccupied or unused building, or a portion of unoccupied or unused space within a building.
Land (Cost of)	The investment, held in fee title, in real estate other than structures and improvements and land acquired for street, road, and flood control purposes.
Maintenance	Expenditures that neither materially add to the value of a facility nor appreciably prolong its life, but merely keep it in an ordinary, efficient operating condition. Maintenance costs are not capitalized.
Modulars	Normally, buildings manufactured at another location and transported either assembled or unassembled to the location where they will be utilized. They are then placed on some form of foundation and connected to water, sewer, and power lines. If previously specifically approved by the SCO, modulars may be treated as a separate class of fixed assets and depreciated on a straight line basis over a period of 12 years or more.
Reconstruction	Major or extraordinary renovation resulting in a significant betterment to a facility.
Renovation	Major or extraordinary construction or reconstruction of a facility, the entire cost of which is treated as a significant betterment and added to the cost of the facility (capitalized).
Rental Rate System	Any acceptable costing system that results in charges based on actual costs, regardless of whether the costs are treated as direct or indirect costs and regardless of whether the costs are billed to users or allocated through a cost allocation plan. Rental rate charges may include building depreciation, interest (qualified), bond issuance expenses, utilities, janitorial services, security, parking, etc.
Single Class of Assets	Broadly defined, all buildings, including any appurtenant structures or improvements in connection with the buildings.  Any special use facilities such as waste treatment plants, water treatment plants, parks, etc., may be considered as separate classes of assets, with depreciation computed without regard to the method chosen for the general class of office buildings.



Key Terms

Definition

Structures and  
Improvements  
(Facilities)

Physical properties of a permanent nature: for example, buildings, structural attachments, storage tanks, reservoirs, and parking areas. Sidewalks, trees, and driveways in connection with the structures are recognized to the extent that they are necessary for the use of the facility.

Useful Life

That period of life from the date a facility is purchased, constructed, or altered to the date the facility is no longer efficiently useable without renovation (the latter can be determined by independent appraisal). The period of useful service or useful life established for each facility must include such factors as type of construction, nature of facility use, site location, etc.

## Section 4100: Insurance Costs

Section 22 of the Insurance Code of the State of California defines insurance as "...a contract whereby one undertakes to indemnify another against loss, damage, or liability arising from a contingent or unknown event."

Section 23 of the same code states, "The person who undertakes to indemnify another by insurance is the insurer, and the person indemnified is the insured."

### Section 4110: Definition of Insurance

Industry use of the term "insurance" commonly indicates a method of financing risk by transferring it to a professional risk bearer (insurance company) or to a pool of homogeneous exposures to loss, where "risk" means an uncertainty of loss or injury. In other words, a county or local government is trading a known sum of money (insurance premium) for an unknown sum (the loss paid by the insurance company).

### Section 4120: Types of Insurance Coverage

Typically, insurance coverage found in California counties covers various exposures to financial loss. Following are examples:

**Tort Liability Losses** – Torts are wrongful acts, injuries, or damages, not involving breach of contract, for which a civil action may be brought. Tort losses include general and automobile liability and medical malpractice.

**Property Loss** – Property losses include loss of use and damage to owned or leased property from such hazards as fire, earthquake, flood, explosions, and theft.

**Employee-Related Losses** – Employee-related losses include workers' compensation and various employee-benefit coverages such as medical dental, life, disability, vision, and unemployment compensation.

Protection from such financial loss may be obtained by the purchase of a policy or policies from private insurance companies.

### Section 4130: Definition of Self-Insurance

It has been a common practice for the purchases of insurance to retain a certain amount of the risk through the use of deductibles. In this manner, a county can reduce insurance premiums by agreeing to participate in the payment of losses in some predetermined fashion. In recent years, the insurance premiums for a variety of local government coverages have increased, forcing counties to retain more and more of previously transferred risk through the use of higher deductibles. In many cases, this has led to situations in which counties retain all but the greatest amounts of risk, covering these amounts with excess or umbrella-type insurance policies.

This retention of risk has come to be known as self-insurance; today self-insurance is common in the risk management programs of California counties. For the purposes of this handbook, the

term self-insurance means the self-retention (non-transfer) of risk in accordance with sound insurance principles, including resource planning and reservation.

### **Section 4140: Insurance Pooling**

Under an insurance pooling arrangement, a county enters into a joint-powers agreement with other local governmental entities, usually with other counties, cities, or special districts in the same geopolitical area or of similar economic size. These arrangements can be for the purposes of commonly insuring all participants for just one category of insurance, such as employee benefits, or for many types of insurance. An example of the latter is the Trindel Insurance Fund, whose members consist of California counties. Trindel provides workers' compensation, general liability, and property damage insurance for its members.

Insurance pooling arrangements operate in much the same manner as risk management works in a county. The pool provides for risk administration, claims adjustment, legal services, loss payments, purchase of excess insurance policies, and all other activities related to the operation of a comprehensive insurance program.

### **Section 4150: Self-Insurance Programs**

Self-insurance programs are inseparable from risk management. For example, some of the functions necessary to operate a self-insurance program are identical to those required in risk management. A statement of purpose program administration, including safety, claims, and legal services coordination, and cost savings analysis are all integral parts of both risk management and self-insurance administration. Other elements that enter into the administration of self-insurance programs are methods of funding and cost distribution to benefitting departments.

The following statement, authored by Gregory Trout and published in Bulletin #3, "Self-Insurance Liability Exposures," March 1977, by the County Supervisor's Association of California, provides an excellent summary of a self-insurance program and its interrelationship with the risk management concept:

A self-insurance program is, in effect, a governmental insurance company and performs the same functions as a commercial insurer. It administers its plan, pays claims, secures legal defense, provides safety inspection services, sets premiums, and achieves a spread of risk, keeping in mind that the principal goal of the self-insurance program is to protect the entity's assets from the risk of loss at a minimum of cost.

### **Section 4160: Insurance Loans**

Loans may be made from insurance funds only to other county funds and under the same criteria imposed for loans from ISFs (see Section 2250). Such loans may be made only if:

- The loan is recorded as an amount receivable in the insurance fund's financial records;
- The loan is repaid with interest computed at the same rate that the insurance fund could have earned had the loan not taken place;

- The period of the loan does not exceed 36 months;
- The loan does not impact adversely on the insurance fund's current cash requirements;
- The loan is included in the measurement of the insurance fund's assets for any actuarial purposes; and
- The loan agreement includes a clause that permits the insurance fund to demand accelerated repayment of all or any part of the loan if its cash requirements so dictate.

If a loan made by an insurance fund is not fully paid back by the end of the loan period, the loan is regarded as a "bad debt" and requires an immediate rebate from the county general fund to all grant programs.

### **Section 4170: Comments on Self-Insurance**

For public entities, self-insuring, as opposed to purchasing insurance, can provide several advantages. Because of the recent changes in the attitude concerning the immunity of governmental entities from lawsuits, insurance premiums from private carriers have increased dramatically, due in part to increased court awards. The entire premium dollar is not used for payment of losses. Expenses for taxes, asset acquisition, and general operations, as well as an increment for profit and contingency, are all built into the premium charge. By self-insuring, local governments can save some of the premium dollars that are not used for loss of payment and general operations. Additionally, the amounts previously used to pay premiums can be invested, with the interest earnings used to further reduce the self-insurance program costs.

Another advantage to self-insurance is the improved loss and claims control that can be realized by the implementation of an effective safety and loss prevention program. Under self-insurance programs, the responsibility of losses, and all costs associated with them, can be assigned directly to the departmental managers who can effectively control the risks involved. In this manner, the county managers and personnel take an active role in implementing safety and loss prevention programs, reducing overall program costs to the county.

The process of becoming self-insured presents several obstacles that require the strict attention of those persons responsible for establishing the self-insurance program. Moving from a highly insured position to one of self-insurance should be a calculated, step-by-step process. Consideration should be given to the transfer of responsibility from a decentralized operation to the risk manager. Current loss-reporting systems should be evaluated for efficiency and effectiveness where they exist, and developed where they do not exist. The coordination of information and policy coverage with existing carriers can result in minimal disruption in insurance coverage while producing the potential for cost savings in becoming self-insured.

### **Section 4180: Definition of Non-Insurance for Grant Reimbursement Purposes**

A county is considered non-insured if it elects not to purchase insurance or establish a self-insurance program for a particular type of coverage but instead chooses to finance any losses

through current or special budget appropriations, bond issues, or other spur-of-the-moment financing. Payments of losses under such a system will not be eligible for grant reimbursement purposes except where specifically provided for in a grant agreement.

## Section 4200: Risk Management

Prior to the widespread use of self-insurance, it was necessary for a county to select and acquire the particular combination of insurance policies that offered the greatest protection for the least amount of money. Insurance administration claims adjustment, loss funding and payment, and legal services were left for the insurance company to handle. However, as a county retains more, or all, of the risk in each insurance category, county management must now perform, all or in part, functions previously performed by insurance companies.

A risk management program deals with the evaluation of pure risks (whether insurable or uninsurable) and devises the best methods to treat them. A risk manager must decide on the best method of handling each type of risk exposure, whether it is the purchase of insurance or some other technique of risk financing or reduction; an insurance manager primarily concentrates on managing the insurance policies purchased by the county.

Risk management is a comprehensive managerial challenge covering all aspects of the insurance field. The staff members in a risk management department are frequently involved in such tasks as risk evaluation safety programs, claims adjusting, legal services coordination, property protection programs, insurance policy evaluation, and many other related areas. Because of the many functions involved, it is desirable for counties to centralize their risk management activities.

### Section 4210: Identifying the Costs of Risk

The risk management concept dictates that certain categories of expense be considered as the true costs of risk. The categories listed below should be dealt with by the county when establishing and operating a self-insurance program.

- **Risk Management Administration** – As detailed in Section 4220 Risk Management and Self-Insurance Program Elements, all administrative functions formerly provided by insurance companies now need to be provided by either county staff and/or contracts with industry specialists.
- **Loss Prevention Costs** – The risk management concept for self-insurance programs dictates that the county be dedicated to an active program of loss reduction by reducing its exposures to loss. The safety and loss prevention programs effectively implemented by the risk manager and the county staff will lead to reductions in the overall costs of the self-insurance program.
- **Uninsured Losses** – The level of uninsured losses, including loss expense costs, is that level of risk that the county chooses to self-retain. The chief financial officer and the risk manager generally determine this level, after consideration of how unbudgeted losses would affect the county's present and future financial condition. In general, the county should retain all risks to the maximum tolerable level. Beyond this level, excess insurance needs to be purchased to provide protection in the event of a catastrophic loss.

- **Insurance Premiums** – The payment of insurance premiums represents a method of funding losses for coverage for which the county chooses not to self-insure.

### **Section 4220: Risk Management and Self-Insurance Program Element**

Certain elements are necessary for the effective operation of a self-insurance program. The following list was summarized from interviews with risk managers as well as from articles and publications covering the field of governmental self-insurance. The list represents that combination of elements necessary for a county to establish and operate a model risk management and self-insurance program.

All self-insurance programs must be operated in conjunction with a comprehensive risk management program established by the county board of supervisors. All functions previously performed by an insurance company should now be provided by either the county staff or through contracts with industry specialists.

A risk management policy statement should be issued, clearly defining to all levels of the county the objectives of the risk management program. This statement must include:

- The goals of the risk management program;
- Authority and responsibility of the risk manager;
- Coordination of the risk management activities;
- Guidelines on risk management through the use of deductibles or self-insurance;
- The centralization of insurance responsibilities; and
- Support of the risk management philosophy of loss reduction and prevention at all levels of the county.

The county should employ the services of an individual familiar with the aspects of managing risk. If the county does not employ a risk manager, the services of a risk management firm may be engaged to provide assistance in establishing and operating the self-insurance program. Additionally, the county staff should receive formal training in the aspects of managing risk, in order to provide for the coordination of risk management responsibility.

At a minimum, the county must provide the following administrative functions and bear the associated costs:

- Risk analysis through actuarial studies and/or loss reporting systems;
- Claims adjusting (in-house or contract);
- Claims auditing (in-house or contract);

- Legal;
- Loss control programs; and
- Other administrative functions, such as those that deal with financial support for salaries, supplies, training, space, and other overhead.

As a part of administrative loss control procedures, a county should implement programs to actively reduce the county's exposure to risk from accidental loss, in accordance with its Risk Management Policy Statement. These programs should include:

- Employee safety programs and emergency procedures;
- The development of loss control programs to reduce third party claims; and
- The development of loss reporting systems to highlight areas for further risk reduction efforts.

The county should determine the maximum tolerable level of losses it can financially afford. Losses beyond this point should be covered through the purchase of excess insurance. The insurance market should be evaluated periodically to determine if it is more cost effective to purchase insurance below the maximum self-retention level or to self-insure. Excess insurance should be purchased to provide protection above maximum self-retention level.

### **Section 4230: Reserve Development**

As each self-insurance program is established, the county must develop and monitor reserve accounts for each distinct category of potential loss. If reserve accounts are not established in the county's accounting records for each loss category, supplemental schedules must be maintained that provide this information.

Reserve accounts or accrued expenses should be:

- Established by actuarial studies or evaluations of loss histories;
- Discounted for payment in future periods; and
- Adjusted no less frequently than annually to reflect the most current information.

### **Section 4240: Reserves for Catastrophic Losses**

This reserve represents the county's ability to absorb maximum losses as they occur. Excess insurance is usually purchased in conjunction with this ability to fund losses per occurrence as well as total aggregated losses. This reserve should be established with both a maximum and a minimum level, as defined below.



- **Maximum Level** – A realistic estimate must be developed of the maximum losses that the county could incur in a fiscal year. When the maximum reserve level is fully cash-funded, charges to users for the reserve should be reduced or suspended until the reserve approaches the minimum level.
- **Minimum Level** – A realistic estimate of the minimum amount the county needs to cover losses as they occur and still provide financial security to the self-insurance program is also required. When the cash balances fall to the minimum reserve level, reserve charges to users should be re-established or increased to provide additional reserve protection.

### **Section 4250: Reserves for Incurred Losses**

This reserve is directly related to the county’s financial obligations for the types of claims listed below. These reserves should be monitored and adjusted no less frequently than annually to ensure that funds for loss payment are being reserved in accordance with the claims adjuster’s expectations of loss payments. Reserve requirements are established based on the following categories:

- **Claims settled but not paid** – The amount of loss is settled but the claim has not yet been paid.
- **Claims reported but not settled** – A claim has been filed for a loss but an estimate must be developed concerning the potential loss payment. The estimate can be based on:
  - The maximum amount the county could be held liable for upon settlement or award; or
  - The realistic amount the county will be required to pay upon settlement or award.
- **Reserve for incurred but not reported (IBNR) losses** – GASB Cod. Sec. C50.113-114 (Section C50, Paragraphs .113-.114) defines IBNR claims as “claims for insured events that have occurred but have not yet been reported to the governmental entity, public entity risk pool, or reinsurer.” IBNR claims include:
  - Known loss events expected to be presented later as claims;
  - Unknown loss events expected to become claims; and
  - Expected future developments on claims already reported.

Reports should be prepared at least annually for each self-insurance program. These reports should include a reconciliation of reserve levels versus loss payments.

### **Section 4260: Funding Insurance Reserves**

Insurance reserves should be funded with cash and/or investments to provide for payment for losses. When funding for reserves is directly charged or allocated to grant programs, the following requirements are mandatory:

- All reserves must be segregated in restricted accounts or accounted for separately and used exclusively for the purposes for which they were intended. If the money accumulated in a self-insurance reserve is used for other purposes, then a credit in the same amount as the “reserve reduction” must be applied to all departments participating in the self-insurance program. If the entire reserve reduction occurs in one year, then all of the credit must be applied in one year or, in unusual circumstances, amortized over a period negotiated with the SCO.
- All reserves should be invested in interest-earning accounts with interest accruing to the self-insurance program, as mandated by Section 25263 of the Government Code of the State of California. Interest earnings can be used for payment of administrative costs and loss payments, and they should generate rate reductions in charges to users after the maximum reserve levels have been reached.

### **Section 4270: Rate Development**

Counties should have the following points foremost in mind when developing rates to charge the participants in the self-insurance program:

- Reserves should be funded through rate charges to users, accumulating over a period of time.
- A “premium” should be developed for each self-insurance category (i.e., liability, workers’, compensation, unemployment, etc.) based on:
  - Risk-management administrative costs;
  - The cost of excess insurance premiums; and
  - The amounts required to maintain each category of reserve at a safe level. Establishing this requires monitoring the actual losses from claims payments and claim accruals and monitoring payments from and contributions and/or adjustments to each reserve by, at a minimum, worksheet analysis.

Rates should be developed to charge the user departments for their share of the “premium.” Rates should reflect the following factors:

- A factor for loss experience (sometimes referred to as actual loss) – provision should be made to charge some portion of self-insurance costs on the basis of actual loss experience. Loss histories should be developed and maintained by the risk manager and adjusted annually. In order to maintain a “rolling average” each year, losses for the earliest year should be eliminated while losses from the most recent year are added. Five years is the minimum loss-history period that should be used for this moving average,

and a maximum period of seven to ten years is recommended. From 70% to 80% of each insurance premium should be allocated based on experience. Losses charged to departments and/or funds may be limited to a maximum amount (capped) as long as the losses are treated uniformly and consistently (see the following section for further discussion).

- A factor for loss exposure (sometimes referred to as risk) – provision should be made to charge 20% to 30% of each type of self-insurance cost on the basis of the county’s exposure to potential losses.
- The exposure rate should be applied to a base that best measures the exposure. Following are examples:
  - For workers’ compensation and unemployment, the salaries of the individuals covered usually serves as a readily identifiable base. Provision should be made, however, to include those volunteers and other individuals included under this coverage who do not receive payment for their services.
  - Benefit programs generally relate directly to the number of individuals covered.
  - Liability is a complex issue. Consideration must be given to departmental activity in relation to the county population, number of personnel employed, budget size, total payroll, square footage of occupied space or grounds area, or other reasonable exposure measures that contribute to the amount of liability risk related to a department. The number of employees alone is not an acceptable allocation base for the distribution of general liability insurance; the number of employees can be used in conjunction with other data to distribute these costs.

The rates used to charge the costs of each self-insurance program should be reviewed at least annually and adjusted when needed to reflect changes in the cost of providing insurance.

The total costs of the risk management program should be reviewed at least annually and adjusted when needed to reflect changes in the cost of providing insurance.

### **Section 4280: Risk Management Cost Identification**

After the total costs of the risk management program have been accumulated, some means of identifying these costs to the participating funds, departments, and programs must be developed. The following three rules should be applied:

- **Reasonableness** – The cost identification system should be based on common sense and be defended with a rational, logical argument. The allocation base used must have a causal relationship between the cost of coverage and the benefit received.
- **Consistency** – Whatever method of cost identification is chosen, it should be consistently applied, not only during the year but between fiscal years as well.

- **Experience vs. Exposure** – Assigning the greater portion of insurance costs to the departments that have actually sustained losses ensures that these losses are matched to insurance costs. This practice encourages the application of departmental loss management practices and facilitates the identification of operations and procedures that should be addressed by the risk manager. This distribution of insurance cost by experience alone, however, does not take into consideration that, although a department may not have incurred a loss, it still participated in the exposure to potential losses. This is especially true for coverage with the same nature as general liability, where all county departments have potential to incur losses. Thus, the exposure factor plays an important role in the overall development of an insurance cost identification system.

### **Section 4285: Experience vs. Exposure**

When a county is developing its cost identification, allocation, and billing procedures for insurance purposes, the county should rely on past experience to develop the division between exposure and experience, as described above. If a county's loss experience is insufficient, it should contract with one of the insurance-consulting firms specializing in this area. The consulting firm could set up a self-insurance operation that includes the means of developing charges to the participating departments. Initially, the division between the experience and exposure factors could be arbitrarily determined. As the county's loss history is developed over a period of time, the emphasis on historical losses could shift the weighting of this division towards the experience factor.

If possible, a county should initially establish the experience/exposure division at 50/50. After five years of loss history, a 70/30 division favoring experience may be determined as being more realistic. After ten years of loss history, approximately 80% of the annual premium charge would be based on the average loss history, with 20% of the annual premium distributed on the exposure to potential losses.

Because each county's loss experience for its various insurance coverages is unique, the SCO does not attempt to dictate an absolute ratio that must be used in dividing total insurance program costs between exposure coverage and loss experience. However, due consideration must be given to the exposure factor. Once the ratio between experience and exposure is established, any changes in these percentages must be made gradually and must be based upon analysis of information provided by the loss histories.

### **Section 4290: Risks of Exceeding Maximum Tolerable Self-Insurance Levels**

A local government may exceed the maximum tolerable risk retention level, beyond which uninsured losses will impair its financial stability. This possibility is not purely hypothetical; actual situations of this nature have already occurred across the United States. It is essential that all losses anticipated as being retained be within the financial capacity of the entity, given its various capital and operating requirements. Additionally, layers of insurance above the self-retained levels should be provided so that the risk of loss is greater than the entity is capable of absorbing (catastrophic) is transferred to a carrier outside of the entity. The failure to have reserves for loss contingencies or at least the ability to finance such losses from current appropriations or by borrowing, and the failure to obtain coverage above retained self-insured levels, effectively results in an under-funded or unfunded insurance program.

## **Section 4300: Accounting for Self-Insurance Programs**

Once a county has determined that the use of self-insurance program will be cost effective, a method must be chosen to account for the program. Before the use of self-insurance, most insurance premiums were paid out of either the general fund or a specific fund for which the insurance coverage was purchased. As self-insurance may cover more than one fund, consideration must be given not only to accounting for all of the costs of each self-insurance program but also to identifying the costs to the various funds and departments included in the program's coverage.

GASB Cod. Sec. C50.104-.107, .127-.131 (Section C50, Paragraphs .104-.107 and .127-.131) addresses the subject of accounting for self-insurance programs. These codes recommend the use of an internal service fund to account for the total cost of any self-insurance program, whether the county is wholly or partially self-insured.

### **Section 4310: Reserves and Reserve Accounting**

Section 4260 of this handbook requires catastrophic reserves, incurred loss reserves, and incurred but not reported (IBNR) reserves to be funded with cash and/or investments to provide for the payment of losses. The use of an internal service fund by itself denotes that the moneys collected in the fund have been designated for self-insurance purposes. Net positions that are accumulated in accordance with a current (within the previous two years) study prepared by an independent actuarial consultant should be reported as restricted. From an accounting standpoint, reserves can be reflected within the equity section of the balance sheet by "designating" or "restricting" net positions, whichever is appropriate to the circumstances. This is particularly applicable to the funds that are set aside for catastrophic protection, since such funds may not be routinely accounted for on an accrual basis. Conversely, if an annual accrual is established for either incurred loss expense or incurred but not reported loss expense, it is not necessary to restrict a corresponding portion of net positions.

The SCO will review county insurance funds in order to determine if accrued liabilities and/or restricted net positions are within funding levels recommended by independent actuaries. Insurance funds whose reserves exceed actuarially derived levels will be required to reduce these levels by adjusting their rates or by proportionally refunding their excess reserves to all of the entities that have been assessed insurance charges by the fund. The conditions that a county must satisfy if their grant programs are to participate in county insurance programs are summarized in Section 4410.

### **Section 4320: 2 CFR Part 200 Insurance Guidelines**

The guidelines dealing with insurance are contained in 2 CFR Part 200, Section 200.447 Insurance and Indemnification. Subparagraph a. of this section states, "Costs of insurance required or approved and maintained pursuant to the Federal award are allowable." Subparagraph b. adds, "Costs of other insurance in connection with the general conduct of activities are allowable." In essence, the cost of insurance specifically required by a grant agreement is allowable. Additionally, the costs of insurance purchased in connection with the conduct of general activities undertaken by the county are allowable if the types and extent and cost of this insurance follow general county policy and sound business practices. The

reimbursement of insurance costs includes reimbursement for nominal deductible insurance coverage and minor losses not covered by insurance, such as spoilage, breakage, and disappearance of small hand tools that may occur in the ordinary course of operations.

2 CFR Part 200, Section 200.447(d) allows contributions to a reserve for certain self-insurance programs, including workers' compensation, unemployment compensation, and severance pay. The reserve contributions are allowable, subject to the following provisions:

- The type of coverage and the extent of coverage, and the rates and premiums would have been allowed had the insurance (including reinsurance) been purchased to cover the risks. However, provision for known or reasonably estimated self-insurance liabilities, which do not become payable for more than one year after the provision is made, must not exceed the discounted present value of the liability. The rate used for discounting the liability must be determined by giving consideration to such factors as the non-federal entity's settlement rate for those liabilities and its investment rate of return.
- Earnings or investment income on reserves must be credited to those reserves.
- Contributions to reserves must be based on sound actuarial principles using historical experience and reasonable assumptions. Reserve levels must be analyzed and updated at least biennially for each major risk being insured and take into account any reinsurance, coinsurance, etc. Reserve levels related to employee-related coverages will normally be limited to the value of claims:
  - Submitted and adjudicated but not paid;
  - Submitted and not adjudicated; and
  - Incurred but not submitted.

Reserve levels in excess of the amounts based on the above must be identified and justified in the cost allocation plan or indirect cost rate proposal.

- Accounting records, actuarial studies, and cost allocations (or billings) must recognize any significant differences due to types of insured risk and losses generated by the various insured activities or agencies of the non-federal entity. If individual departments or agencies of the non-federal entity experience significantly different levels of claims for a particular risk, then those differences are to be recognized by the use of separate allocations or by other techniques resulting in an equitable allocation.
- Whenever funds are transferred from a self-insurance reserve to other accounts (e.g., general fund or unrestricted account) refunds must be made to the federal government for its share of funds transferred, including earned or imputed interest from the date of transfer and debt interest, if applicable, chargeable in accordance with applicable federal cognizant agency for indirect cost, claims collection regulations.

In summary, if a type and amount of coverage would be allowed by purchasing insurance, then a self-insurance program offering the same type and extent of coverage is also allowable. Additionally, if rates could have been computed using total insurance costs as represented by the premium, as in workers' compensation coverage, for example, then rates can also be computed to assess county funds and departments for self-insurance program costs. Self-insurance rates are not limited to the premiums and rates that would have been used had insurance been purchased.

Except for the above, if actual losses could have been covered by purchase of insurance or by a self-insurance program but were not, then these actual losses are to be considered unallowable costs for grant reimbursement purposes. However, actual claims paid to or on behalf of employees or former employees for workers' compensation, unemployment compensation, severance pay, and similar employee benefits (such as post-retirement health benefits permitted by 2 CFR Part 200, Section 200.431(h)) are allowable in the year of benefit, provided:

- The non-federal entity follows a consistent costing policy; and
- Claim costs are allocated as a general administrative expense to all applicable activities of the non-federal entity.

## **Section 4400: Requirements for Grant Reimbursement of Insurance Costs**

This section summarizes the conditions under which grant programs may participate in the reimbursement of purchased insurance or self-insurance program costs.

Where the county has chosen to purchase a particular coverage from an outside carrier rather than to self-insure, the cost of those premiums is allowable for grant reimbursement purposes when distributed to the benefitting departments.

### **Section 4410: Conditions**

When a county chooses to use a self-insurance program for a particular type of coverage, it must meet the following conditions:

- All county self-insurance programs must be established and operated in conjunction with the guidelines in Section 4100 through 4400. Non-compliance with one or two points in these guidelines will generally result in suggestions for improvements in future years. Material non-compliance will be determined only by the SCO. Material non-compliance can result in the disallowance of self-insurance costs charged to grant programs.
- If a county chooses not to finance any losses through special budget appropriations, bond issues, or other spur-of-the-moment public financing, this is considered a system of “no insurance.” Payments of losses under such a system are not eligible for grant reimbursement purposes, unless specifically provided for in a grant agreement.
- Cost participation through grant reimbursements is allowed for workers’ compensation and unemployment compensation insurance programs where the county follows a consistent practice of expensing normal losses directly to the departments in the year of occurrence. Because the intent is not to inequitably burden any one grant program, grantee departments must spread these actual losses equitably among their programs, and the county should still provide protection against a potential catastrophic loss from being charged solely against one department’s budget.
- All self-insurance programs in use by the county must be managed in accordance with sound insurance principles and practices, including adequate resource planning and reservation. This means the establishment of cash reserves adequate to cover the self-retained loss anticipated by the county. These cash reserves must be treated as “inviolable” and not used for any purpose other than, for which they were intended. If the money accumulated in a self-insurance reserve is used for other purposes, a credit in the same amount as the “reserve reduction” must be applied to all departments participating in the self-insurance program, or a cash refund may be made.
- According to the County Budget Act, Government Code Section 29000, et seq., reserves will be established by the county board of supervisors. Therefore, all self-insurance programs using reserves must have such reserves established by board-of-supervisor



action. The level of reserves should be established in accordance with sound insurance principles and practices, including actuarial studies or comprehensive evaluation of past loss experience, and the level must be consistent with the objectives of the self-insurance coverage.

- If reserves have been established through charges to departments, the money collected must be invested in interest-earning activities. Where reserves were established by transfer from the general fund and have not been charged directly to use or allocated through the cost plan, the money should be invested in interest-earning activities to achieve an overall cost reduction of the self-insurance program.
- All costs of the self-insurance program, including loss payment administrative expenses, and premiums for excess insurance coverage, should be paid out of an internal service fund as recommended by the SCO. This fund can be financed through charges to either the benefitting departments or participating funds. If the latter charge-out system is chosen, further allocations should identify costs to the departments within each fund.
- If a county chooses not to implement internal service fund accounting for its self-insurance programs, then the self-insurance reserves described in Section 4300 of this handbook must be accounted for in trust fund(s) to be eligible for grant reimbursement. Contributions from each participating fund to the trust fund will be invested and subsequently used for all loss payments under the program. Only these contributions can be allocated to all departments within each participating fund. Actual loss payments made out of the trust fund will not be eligible for reimbursement. If previously set forth in the county's self-insurance resolution, any risk management expenses or excess insurance premiums paid out of the general fund can also be allocated to the benefitting departments.
- Grant reimbursement participation in self-insurance program costs will be allowed up to the maximum reserve level established plus the attendant administrative expenses of the insurance program. Large increases in contributions to a self-insurance reserve should be discussed with the SCO to determine if allocation over a period of years is necessary and to ensure proper treatment in the computation and use of carry-forward and estimated costs.
- Each type of insurance should be accounted for separately, but separate funds are not required. The SCO recommends, and counties are encouraged to use, an internal service fund in accounting for self-insurance programs.

A comprehensive description of each self-insurance program must be included in the cost plan. The following information should be submitted or updated annually by the county risk manager:

- A description of the types of coverage for which the county is self-insured;

- The amount of current self-insurance retention for each type of coverage, and whether or not excess insurance coverage is purchased;
- The method used to set the maximum serve level and the current funding level of each self-insurance program reserve;
- The method by which insurance costs are distributed to insurance pool participants, including percentages assigned to experience and to exposure, the number of years used to determine loss experience, and the factor(s) used to assess loss exposure;
- The method of accounting for each self-insurance coverage (trust fund reserve, internal service fund); and
- The most recent financial statements of the trust or internal service fund. These must include: a listing of all transfers into and out of the fund; a copy of the current actuarial report; and a description of the method of cost identification and allocation to participating departments for each type of insurance. New actuarial studies for each major risk being insured must be procured no less frequently than once every two years.

Completion of Exhibit 4401 for each self-insured program will provide the necessary information. An alternate format may be used, provided the same information is submitted.

### **Exhibit 4401**

Please visit the “Forms” section of the County Cost Plans Unit website for the latest version of the Self-Insurance Program Data Sheet (Exhibit 4401):

[https://sco.ca.gov/ard\\_county\\_cost\\_allocation.html](https://sco.ca.gov/ard_county_cost_allocation.html)

## **Exhibit 4402: Insurance Terminology**

<u>Key Terms</u>	<u>Definition</u>
Aggregate (Stop-Loss)	Excess coverage with a “deductible” applying to losses on an annual, not a per-occurrence, basis.
Catastrophic Reserve	A portion of the reserve fund used to protect the county from a loss of an unexpected large amount. Sometimes improperly called a contingency reserve or surplus reserve.
Cost/Benefit Analysis	An analysis of possible alternatives by the differences in their costs and the expected benefits to be received.
Deductible	Amount the insured agrees to pay on each loss before the insurance carrier begins contributing towards the loss.
Excess Insurance	Coverage purchased to pay catastrophic or “shock losses” above the normal level of losses.
Incurred but not Reported (IBNR) Losses	Losses arising from incidents where a claim has not yet been reported. Insurance companies are required to make an estimate of their IBNR losses.
Incurred Loss - Reserving	Sufficient funds typically established through the budget process to meet both paid and outstanding losses likely to occur during a policy year.
Layer	A level of insurance limits. A primary layer may be insurance limits of \$500,000 per person and \$500,000 per occurrence; an excess layer may be the next \$500,000 per person above that.
Maximum Reserve Level	A predetermined maximum amount that a reserve is allowed to reach. Once this level is reached, further contributions are not made.
Pooling	The sharing of risk by several entities exposed to the same hazards.
Retention	The amount of loss exposure retained by an entity. Financially, this is similar to an insurance deductible.
Risk	Exposure to loss.
Risk Management	The evaluation of exposure to loss, and the implementation of the most economical and effective way to handle that exposure.
Self-Insurance	Handling losses through the use of a self-funded plan to assume the risk of loss. A self-insurance plan may have all or some of the characteristics an insurance company: personnel, loss prevention, etc.

## **Contact Information**

The SCO is available to assist counties with any cost plan issues, questions, and concerns. Comments and suggestions are always welcome. Please contact your county's assigned cost plan analyst or email the County Cost Plans Unit at [LGPSDCountyCostPlans@sco.ca.gov](mailto:LGPSDCountyCostPlans@sco.ca.gov). You can also write to us at the following address:

State Controller's Office  
Local Government Programs and Services Division  
Local Government Policy Section  
County Cost Plans Unit, Suite 740  
P.O. Box 942850  
Sacramento, CA 94250