

B-146285-O.M.

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Implementation of Federal Management Circular 74-4  
(B-146285)

This responds to your memorandum of June 18, 1976, relative to a review of the implementation of Federal Management Circular 74-4, in which you asked these questions:

**QUESTION 1:** Is the use of predetermined indirect cost rates in grants and contracts with State and local governments authorized by law or Comptroller General decision?

**ANSWER:** Predetermined indirect cost rates in contracts with State and local governments are not authorized by law or Comptroller General decision. Nevertheless, grants containing these cost methods are not forbidden by law or Comptroller General decision.

**QUESTION 2:** Is the fixed or predetermined indirect cost rate with a following year adjustment to reflect actual cost incurred similarly authorized for use, even though this practice, referred to as the "roll forward" method, can result in the adjustment being paid from following year appropriations?

**ANSWER:** No. Adjustments made to reflect actual indirect costs incurred are legal only to the extent that they are made with funds appropriated in the same fiscal year as the original contract or grant.

These issues are discussed in greater detail in the attachment.

Attachment

cc: Mr. Lowe, GGD  
Mr. C'Toole, CGC  
Mr. Gellman, CGC  
Index and Files  
Index Digest

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## ATTACHMENT

Implementation of Federal  
Management Circular 74-4

## DIGEST:

Predetermined indirect cost rates in contracts with State and local governments are not authorized by law or Comptroller General decision. The express prohibition contained in 10 U.S.C. 2306(a) (1970) concerning the use of predetermined indirect cost rates in cost-type government contracts does not appear to apply to grants to State and local governments.

A "roll forward" method that funds adjustments to indirect contract or grant costs with appropriations made subsequent to those made available in the year of the contract or grant is prohibited by 31 U.S.C. 712a (1970).

Federal Management Circular (FMC) 74-4 was originally promulgated on May 9, 1968, by the Office of Management and Budget as Circular A-87. On May 9, 1973, Executive Order No. 11717, 3A C.F.R. 176 (1973), 31 U.S.C. §16 (Supp. IV, 1974), transferred certain OMB functions to the General Services Administration (GSA). On July 18, 1974, GSA issued FMC 74-4, 34 C.F.R. §253 (1975), as a replacement for OMB Circular A-87. The Circular deals with cost principles applicable to grants and contracts with State and local governments.

QUESTION 1: Is the use of predetermined indirect cost rates in grants and contracts with State and local governments authorized by law or Comptroller General decision?

ANSWER: Under a predetermined indirect cost rate system, a rate is agreed to in advance by the parties to a Government grant or contract, as representing a final rate that will be effective during a future period. This rate, which is not generally subject to subsequent adjustment, is applied to the direct costs of a project to determine the indirect cost allotment for that project. Since this Office has treated predetermined indirect cost rates as applied to Government contracts

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differently from those applied to Government grants, contracts and grants will be treated separately in our answer.

### Contracts

Predetermined indirect cost rates in contracts with State and local governments are not authorized by law. 10 U.S.C. 2306(a) (1970) provides that "the cost-plus-a-percentage-of-cost system of contracting may not be used." 41 U.S.C. 254(b) (1970) contains identical language. We held in 35 Comp. Gen. 434 (1956) that the application of fixed predetermined indirect cost rates to direct costs violated 10 U.S.C. 2306(a) (1970). It was to overcome this decision of the Comptroller General that Congress enacted Public Law 87-638, 41 U.S.C. 254a, providing a specific exception to the cost-plus-a-percentage-of-cost prohibition in the case of educational institutions. That statute provides:

"Hereafter provision may be made in cost-type research and development contracts (including grants) with universities, colleges, or other educational institutions for payment of reimbursable indirect costs on the basis of predetermined fixed-percentage rates applied to the total, or an element thereof, of the reimbursable direct costs incurred."

With regard to extending this legislation, the House Report, H.R. Rep. No. 1485, 87th Cong., 2d Sess. (1962), stated at the bottom of page 3: "The passage of this bill, of course, is no precedent for further exceptions and none are likely unless some great necessity demands." Since no further legislative exceptions have been enacted, the use of predetermined indirect cost rates except as provided in 41 U.S.C. 254a is in contravention of the cost-plus-a-percentage-of-cost prohibition. See B-157584, January 8, 1971, where it was held:

"Absent some special exemption permitting the use of predetermined indirect cost rates in cost-type contracts with nonprofit organizations and institutions, no legal basis exists for our Office to authorize such contracting and legislation would be necessary to permit it."

Grants

In B-157584, January 8, 1971, following a statement that predetermined indirect cost rates applied to cost-type contracts with State and local governments would be in contravention of the cost-plus-a-percentage-of-cost prohibition, it was said: "However, it is permissible to use predetermined indirect cost rates in grants made to nonprofit institutions other than educational institutions," citing B-157584, November 26, 1965. The issue presented in 1965 was whether the National Science Foundation (NSF) could legally develop predetermined indirect cost rates for use in making grants to nonprofit institutions other than educational institutions. It was there pointed out that in 35 Comp. Gen. 434 (1956) it was held only that contracts entered into on a cost-plus-a-percentage-of-cost basis were illegal, and not that such a system of payment of overhead in grants was illegal. In approving the NSF proposal for funding grant overhead, the Comptroller General did so with the understanding "that the proposed procedures will be used only for basic research project grants which are fixed in amount with NSF having no responsibility to make additional funds available regardless of what the total cost may be and that the grantees will be required to share some portion of the cost of each research project \* \* \* " B-157584, November 26, 1965. The NSF proposal was deemed appropriate, "at least on a trial basis" and was not "objected to by this Office unless subsequently found by us to be disadvantageous to the Government." Id.

It can be seen from the foregoing that while this Office has not found predetermined indirect cost rates as applied to grants to be illegal, the preferred system is one that determines, by audit, the actual indirect project costs. Consequently, the answer to your first question pertaining to grants depends upon the existence of safeguards that protect against the grantee benefiting from allowing costs to accrue in order to obtain a percentage of the incurred cost.

QUESTION 2: Is a fixed or predetermined indirect cost rate with a following year adjustment to reflect actual cost incurred similarly authorized for use, even though this practice, referred to as the "roll forward" method, can result in the adjustment being paid from following year appropriations?

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**ANSWER:** No. The "roll forward" method provides for "carrying" or "rolling" forward into a subsequent fiscal year, the difference between the amounts reimbursed using the predetermined rate and the amounts which would have been reimbursed had the actual rate been known for the period that was predetermined. This "roll forward" method is forbidden to the extent that adjustments made to reflect the actual indirect costs incurred are made with funds appropriated in a fiscal year subsequent to the year of the original grant or contract. This prohibition is contained in 31 U.S.C. 712a (1970) which provides:

"Except as otherwise provided by law, all balances of appropriations contained in the annual appropriation bills and made specifically for the service of any fiscal year shall only be applied to the payment of expenses properly incurred during that year, or to the fulfillment of contracts during that year, or to the fulfillment of contracts properly made within that year."

The purpose of this provision is to restrict the use of annual appropriations to expenditures required for the service of the particular fiscal year for which they are made. See 42 Comp. Gen. 272, 275 (1962); 55 Comp. Gen. 768 (1976). In 55 Comp. Gen. 768 (1976) it was held that an Army proposal to complete prior year contracts that were executed in violation of the Antideficiency Act, 31 U.S.C. 665 (1970), by applying current fiscal year funds was improper in light of the rule that expenditures attributable to contracts made under particular appropriations remain chargeable to those appropriations. This Office has long held, consistent with 31 U.S.C. 712a (1970), as well as 31 U.S.C. 665(a) (1970), that a claim against a fixed year appropriation, when otherwise proper, is chargeable to the appropriation for the fiscal year in which the liability was incurred. See, e.g., 18 Comp. Gen. 363, 365 (1938); 50 Comp. Gen. 589, 591 (1971).

In view of the foregoing it is unnecessary to distinguish between a fixed and a predetermined indirect cost rate or between a cost-type government contract and a grant. In the case where indirect costs are not ascertainable at the time of the grant or contract, the proper method is to apply a provisional indirect cost rate in which the rate has been recognized

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by both parties to be subject to adjustment, based on a subsequent determination of the actual indirect cost incurred. 48 Comp. Gen. 186 (1968). In this situation the appropriation originally obligated by the grant or contract involved would be the only appropriation legally available to pay amounts due as a result of any required upward adjustment of the provisional indirect cost rate set forth in the contract or grant. Cf. 20 Comp. Gen. 370 (1941); 50 Comp. Gen. 589 (1971).

SPECIAL STUDIES AND ANALYSIS

By: Jeffrey O'Toole

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