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ACTION BY: Regional Offices
State Agencies

INFORMATION FOR: Child Nutrition Division
Grants Management Division

Financial Management - Child and Adult Care Food Program

TABLE OF CONTENTS

Page

I PURPOSE 1

II AUTHORITY 1

III ABBREVIATIONS 3

IV SCOPE 3

V DEFINITIONS 3

VI MONITORING NONPROFIT FOOD SERVICE STATUS 5

A Public and Private Nonprofit Institutions Not Excluded 5
B Cost Based Reimbursement Not Excluded 5
C Determining Nonprofit Food Service Status 5
D Excessive Nonprofit Food Service Account Balances 7

VII BASIC GUIDELINES FOR DETERMINING ALLOWABILITY OF COSTS 9

A General Criteria 9
B Allocation of Costs 12
C Direct and Indirect Costs 12
D Operating and Administrative Costs 13

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Page

VIII STANDARDS FOR ALLOWABLE COSTS 15

A Cost Principles 15
B Disclosure 15
C Special Considerations in Determining Allowability 16
D Generally Allowable Costs 16
E Prior Approval 16
F Specific Prior Written Approval 16
G Unallowable Costs 17
H Program Costs 17
I Selected Items of Cost 19

IX BASIC GUIDELINES FOR CACFP PAYMENTS AND USE OF FUNDS 81

A Reimbursement Methods 81
B Applicable Reimbursement Methods 81
C Advance Payments 87
D Other Factors 90
E Records 100

X FOOD DONATION 105

A General 105
B Recordkeeping 105
C Cash-in-Lieu of Commodities 105
D Donated Food Processing 105

XI IMPLEMENTATION 107

XII OFFICE OF MANAGEMENT AND BUDGET APPROVAL 107

EXHIBITS

A Glossary

B Food Cost

C Index

(EXHIBITS)

D Suggested Format for Recording Equipment and Depreciation

E Suggested Format for the Cost of Goods Used

F Suggested Format for a Purchase Record

G Suggested Format for Inventory Reconciliation

H Suggested Format for an Inventory Record

Food & Nutrition Service

FNS INSTRUCTION

U.S. DEPARTMENT OF AGRICULTURE
3101 PARK CENTER DRIVE
ALEXANDRIA, VA 22302-1500

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Financial Management - Child and Adult Care Food Program

I PURPOSE

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

A Assure that costs charged to the nonprofit food service are for food service provided principally to enrolled, eligible participants; and where applicable, that costs claimed for reimbursement under the CACFP are allowable, i.e., necessary and reasonable for effective and efficient operation of the nonprofit food service;

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

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

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

II AUTHORITY

The CACFP is authorized by Section 17 of the National School Lunch Act, as amended. Program regulations issued by the Department are found in 7 CFR Part 226. The uniform requirements for the administration of grants and the principles for determining applicable costs and factors affecting allocation of costs for management of grant

(II)

programs are provided in 7 CFR Part 3016, Uniform Administrative Requirements for Governmentwide Debarment and Suspension (Nonprocurement); 7 CFR Part 3018, New Restrictions on Lobbying; 7 CFR Part 3019, Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations; and in OMB Circulars A-87, Cost Principles for State and Local Governments; A-122, Cost Principles for Nonprofit Organization, and 48 CFR Part 31, Contract Cost Principles and Procedures.

Audit requirements are contained in 7 CFR Part 3052, Audits of States, Local Governments and Non-Profit Organizations and OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations.

III ABBREVIATIONS

ADP - Automated Data Processing
CACFP - Child and Adult Care Food Program
CFR - Code of Federal Regulations
EFT - Electronic Funds Transfer
FAR - Federal Acquisition Regulations
FLSA - Fair Labor Standards Act, 26 CFR Part 516
FNS - Food and Nutrition Service
FNSRO - Food and Nutrition Service Regional Office
FSMC - Food Service Management Company
GAAP - Generally Accepted Accounting Principles
GSA - General Services Administration
IRS - Internal Revenue Service
OMB - Office of Management and Budget
ROAP - Regional Office Administered Program
U.S. - United States
USDA - United States Department of Agriculture

IV SCOPE

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

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

V DEFINITIONS

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

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VI MONITORING NONPROFIT FOOD SERVICE STATUS

All participating institutions must operate a nonprofit food service principally for the benefit of enrolled participants and maintain records documenting the operation of that food service. Independent centers, sponsors of day care homes and sponsors of centers must meet this requirement. While day care homes are exempt from maintaining a nonprofit food service, sponsors of affiliated centers must maintain a nonprofit food service on behalf of all sponsored affiliated centers and sponsors of unaffiliated centers must ensure that all sponsored unaffiliated centers maintain a nonprofit food service. State agencies are required to conduct reviews of participating institutions to ensure these requirements are met.

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

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

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

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

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

When an institution does not operate the food service for its own enrolled participants or when its total food service is not conducted principally for the benefit of its own enrolled

(VI C 2)

participants, the nonprogram and program components of the food service operation must be segregated. Through this separation, the institution must ensure that the nonprofit food service program component does not support any nonprogram food service activities. Unallowable support occurs when nonprogram costs are assigned to the nonprofit food service or when program revenues are not used for allowable food service expenses or not retained in the nonprofit food service account. The institution must maintain accounting records documenting proper cost allocation between the program and nonprogram components of its food service operation and the State agency must ensure through the review process that all CACFP reimbursements are used solely for conducting nonprofit food service operations.

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

4 Review Elements. Nonprofit status is determined through:

a Identifying all nonprofit food service revenues, including;

(1) CACFP reimbursements,

(2) Income to the program and

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

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

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

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

(C 4)

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

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

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

2 The institution cannot transfer the excess funds to nonprogram operations or use the excess funds for increases in salaries or fringe benefit costs when the sole purpose of the increase is to reduce an excess nonprofit food service program balance.

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VII BASIC GUIDELINES FOR DETERMINING ALLOWABILITY OF COSTS

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

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

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

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

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

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

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

(VIII A)

3 Allowability. Costs must meet the following factors:

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

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

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

(2) Arms-length bargaining;

(3) Federal and state laws and regulations;

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

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

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

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

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

(VII A 3)

f Multiple Awards. The cost must not be assignable or included as a cost to any other current or prior federally financed program, but see IX D 5, below.

g Consistent treatment. The cost must be treated consistently through the application of generally accepted accounting principles.

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

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

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

(1) Have been incurred;

(2) Are program costs; and

(3) Comply with all applicable laws, regulations and this Instruction.

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

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

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

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

(VII)

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

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

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

a Examples of these direct costs include:

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

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

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

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

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

(VII C 2)

a Examples of common indirect costs are:

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

(2) Costs of operating and maintaining facilities;

(3) Salary of the receptionist; or

(4) Salaries of the central accounting staff.

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

(1) The institution must use OMB Circulars A-87 and A-122 and FAR Part 31, as applicable, when developing a cost allocation plan. An institution should contact its State agency for additional guidance.

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

1 Operating costs are limited to the institution's allowable expenses of serving meals to eligible participants in eligible child and adult centers. Except as provided in §226.18(a)(7), sponsors of day care homes do not have allowable operating expenses.

a Examples of operating costs are:

(1) Food;

(2) Food service labor;

(3) Nonfood supplies; and

(4) Food service equipment.

(VII D)

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

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

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

(2) Reviewing and approving income eligibility statements;

(3) Providing nutrition education to food service staff;

(4) Providing Program training for institution staff and facilities; and

(5) Conducting CACFP monitoring and training visits to sponsored facilities.

VIII STANDARDS FOR ALLOWABLE COSTS

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

A Cost Principles. Institutions are responsible for accounting for costs correctly and for maintaining records and sufficient supporting documentation to demonstrate that costs claimed have been incurred, are allocable to the program, and comply with State agency financial management requirements, this Instruction, and applicable Program regulations and policies. Costs that are not properly documented and recorded pursuant to generally accepted accounting principles, State agency financial management requirements, the applicable OMB Circulars and this Instruction are unallowable.

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

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

(VIII)

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

D Generally Allowable Costs. Generally allowable costs are the customary costs that occur in the routine operation of the CACFP and which are allowed by this Instruction, OMB Circulars, FAR Part 31, Federal regulations and FNS and State agency policies, guidance and instructions. While generally allowable, an institution must disclose these costs in the administrative budget submitted to the State agency (§226.15(b)(3)) and these costs must still be approved in advance by the State agency through the annual management plan and budget submission process (§226.6(f)). Approval of the budget results in the approval of the budget line items but is not a guarantee of allowability of any particular cost or funding of the budget line item.

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

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

(VIII F)

customarily incurred in the routine operation of the CACFP but can sometimes be necessary and reasonable for proper and effective Program operations. Approval of a budget line item does not constitute adequate specific prior written approval for these costs. The institution must specifically identify and request approval of these costs during the annual budget approval process or submit a separate request to the State agency. Whether submitted during the budget approval process or separately, the State agency must approve or deny these specific requests in writing. Costs requiring specific prior written approval may include costs identified in the OMB Circulars or the FAR as allowable costs, but due to limitations imposed by CACFP statutory, regulatory and policy considerations may not be allowable program costs.

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

H Program Costs. The term "program" in this Instruction means the institution's food service conducted primarily for the benefit of enrolled participants. When capitalized, the term Program refers specifically to the CACFP. For sponsors of day care homes the term "Program" should always be substituted for "program" because allowable costs for these sponsors are limited to CACFP costs.

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(VIII)

I Selected Items of Cost. The following costs frequently occur in organizations operating the CACFP. These costs include generally allowable costs, costs requiring prior approval, costs requiring specific prior written approval and unallowable costs. For additional information, the applicable OMB Circulars (A-87 for public institutions; A-122 for private nonprofit organizations) and FAR Part 31 for proprietary institutions should be consulted.

1 Accounting. Institutions must maintain accounting systems and account for costs in accordance with generally accepted accounting principles.

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

b Unallowable Costs. The costs of maintaining central accounting records to meet corporate, incorporation and tax requirements.

2 Administrative Appeal Costs. Institutions have a right to appeal certain actions of the State agency (§226.6(k)). Costs allowed by this section can become unallowable in certain cases. (See 12, below.) The costs of provider appeals are included under Participant Support Costs. (See 30 a (3), below.)

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

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

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

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

b Unallowable Costs. Costs for civil, legal or other proceedings including:

(VIII I 2 b)

(1) The costs of pursuing a judicial review of a decision rendered by hearing official pursuant to §226.6(k).

3 Advertising and Public Relations Costs. Advertising media includes newspapers, magazines, radio and television, direct mail, world wide web pages, trade papers, imprinted buttons, pins, banners and similar goods. Public relations means those activities dedicated to promoting the CACFP.

a Allowable Costs.

(1) The cost of advertising media to:

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

(b) Recruitment of personnel for the program; and

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

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

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

(b) Increase an institution's CACFP participation.

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

(1) Costs to solicit nonprogram business;

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

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

(VIII I 3 b)

(a) Displays;

(b) Demonstrations;

(c) Exhibits;

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

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

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

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

a Allowable Costs. Either:

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

(2) The full cost of a Program specific audit conducted pursuant to 7 CFR Part 3052.235.

b Unallowable Costs.

(1) Any portion of the cost of a Program or organization-wide audit funded with 1½ percent CACFP audit funds; and

(2) Costs for other audits incurred by an institution to meet State, local or institution needs.

(VIII I)

5 Bad Debts and Losses. Debts and losses result from uncollectible accounts, late payment charges, insufficient fund charges, Program disallowances, audit or review overclaims, other claims, related collection costs and legal fees. Bad debts and losses also include increases in labor or other costs incurred solely for the purpose of maximizing CACFP funds to repay debts or losses and administrative or operating cost deficits resulting from complying with Program requirements or attending training, but see 30 a, below, for allowable participant costs. All bad debts and losses are unallowable.

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

a Allowable Costs. Bonding costs must be in accordance with sound business practices and must be obtained from companies holding certificates of authority as acceptable sureties. A list of these companies is published annually by the Department of Treasury in its Circular 570. When the bond coverage reflects only Federal money, the bond must be made payable to the State agency. Allowable bonding costs are limited to:

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

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

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

(4) The cost of bonding imposed by the State agency as a component of a corrective action plan to resolve serious deficiencies identified pursuant to §226.6(c).

(VIII I 6)

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

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

8 Communications. Communications includes the costs of supplies and services such as telephone, telegrams, fax, license fees for electronic mail software, Internet services, postage and messenger services. Costs for supplies and services must be allocated between program and nonprogram use.

a Allowable Costs. The costs of supplies and services purchased or leased by the institution that are used for program operations.

(1) State agencies may impose prior approval or specific prior written approval requirements for cellular telephones and pagers leased or owned by the institution.

b Unallowable Costs.

(1) Supplies or services leased or purchased by individuals;

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

(3) The cost of communication supplies and services used for nonprogram purposes regardless of ownership.

9 Contingencies. The costs of contributions to a contingency fund or any similar provision for unforeseen events are unallowable. Contingency funds do not include allowable self-insurance reserves (see 21 a (1) (b-c), below) and pension plans established pursuant to IRS and Governmentwide requirements (see OMB Circulars A-87, Attachment B 11(e), A-122, Attachment B 7(h), and FAR 31.205-6(j).

(VIII I)

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

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

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

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

a Allowable Costs.

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

(2) When the proceeding is initiated by a State or local government, FNS may allow the costs when FNS

(VIII I 11 a)

determines the institution incurred the costs as a result of a specific term or condition of the CACFP or as a result of specific written direction of an authorized official of FNS.

(3) When the institution prevails in the proceeding, FNS may allow the costs to the extent that:

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

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

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

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

b Unallowable Costs

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

(a) Conviction;

(b) A determination of organizational liability;

(c) Imposition of a monetary penalty, but not restitution;

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

(VIII I 11 b)

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

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

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

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

(5) The institution's costs in connection with defense against Federal Government claims, judicial appeals, antitrust suits, or prosecution of claims or administrative appeals against the Federal Government, except for appeals pursuant to 7 CFR §226.6(k).

c Documentation Requirements.

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

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

(VIII I 11 c)

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

(b) Provision of adequate nonfederally funded security; and

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

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

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

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

(2) Minor alterations such as adding handrails; and

(3) The costs of fire and safety inspections and licensing fees.

b Unallowable Costs.

(1) Any other cost to meet licensing or alternate approval standards for income eligible homes;

(2) General remodeling or renovation; and

(VIII I 12 b)

(1) All costs of the institution and day care home to meet licensing or alternate approval standards when the day care home is not income eligible (Tier II) to receive these funds.

c Documentation Requirements

(1) The day care home must complete:

(a) An application for participation in the Program;

(b) An income eligibility application that documents the day care home's eligibility as a Tier I provider;

(c) Evidence of the day care home's application for licensing; and

(d) Official documentation of the defects that are impeding approval of the license.

(2) The day care home sponsoring organization must:

(a) Maintain the information identified in c (1) above for each day care home;

(b) Submit a copy of the pre-approval inspection report that identifies the needed supplies or alterations when alternate approval is used;

(c) Submit the fee schedule from the appropriate regulatory/inspection agency for required inspections or licensing/registration to document the cost of such services; and

(d) Maintain receipts, delivery notices, inspection reports, copies of approved licenses/registration, canceled checks and similar

(VIII 12 d)

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

13 Depreciation and Use Allowances (Space, facilities, and equipment). Depreciation is the expense associated with the program's use of space, facilities, and equipment. Depreciation is based on acquisition cost and the life expectancy of the item, and the costs of improvements, alterations or repairs that extend the useful life of the item. A use allowance can only be applied to items that have been fully depreciated by the institution before being placed into use for the program. A use allowance and depreciation cannot be used for the same set of items, except as provided in OMB Circular A-122, Attachment B, item 11 e. An institution cannot use depreciation expense or use allowance charges to remove cash from its program accounts or to reduce the nonprofit food service account cash balance.

a Allowable Costs. Any generally accepted method of computing depreciation may be used as long as the method results in equitable charges considering the useful life of items and the benefits received by the program. The depreciation method used for the program should be consistent with the method used by the institution for its other federally sponsored and nonfederally sponsored activities.

(1) Space and facilities. Whether privately or publicly owned, buildings can be depreciated using 30 year straight line or the depreciation method used and accepted for Federal income tax reporting purposes. The following requirements also apply:

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

(b) All other space and facility depreciation methods require specific prior written approval;

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

(VIII 13 a)

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

(2) Equipment. The institution may use either 15 year straight line depreciation, (5 years for ADP equipment and vehicles), or the depreciation method used and accepted for Federal income tax reporting purposes.

(a) All other equipment depreciation methods require specific prior written approval; and

(b) The maximum annual rate for use allowances for equipment cannot exceed 6 2/3 percent of the acquisition cost.

b Unallowable Costs.

(1) Any portion of the cost of equipment or improvements that are charged to the program (see 16, below) cannot be depreciated whether or not reimbursement is sufficient to cover the amount charged; and

(2) Equipment replacement reserve fund costs, including contributions to a contingency fund.

c Documentation Requirements. All depreciation charged to the program must be documented through depreciation records indicating the amount of depreciation taken each period and when appropriate, prorated between program and nonprogram use.

(1) Property records and inventories. All depreciation charges must be supported by adequate property records and physical inventories that are taken at least once every two years to ensure the items exist, are in good working order and actually used for program purposes. Exhibit D, attached, contains a suggested format and instructions for

(VIII I 13)

recording equipment and depreciation. This format may be adapted for use with other depreciable items. Records in memorandum form can also be used to document depreciation.

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

d Acquisition Cost. The acquisition cost for computing depreciation must exclude any portion of the cost that was paid by the Federal Government, donated by the Federal Government or others, irrespective of where title was originally vested or where it presently resides, and any portion of the cost contributed by the organization to satisfy matching requirements for any federally funded program.

(1) Unknown acquisition cost. With specific prior written approval, a reasonable estimate of the original acquisition cost may be used when actual cost records have not been maintained.

(2) Donated property. The acquisition cost for donated facilities, vehicles or equipment is the institution's costs to obtain and make the property usable; the value of the donation is not depreciable.

e Life Expectancies. Life expectancies will vary for different items and should be established by the institution based upon reasonable criteria and can be subject to specific prior written approval at the discretion of the State agency.

14 Employee Morale, Health, and Welfare Costs and Credits. Employer costs for in-house publications, first-aid clinics, recreational activities, employee counseling services and other expenses in accordance with the institution's established practice or custom for improvement of working conditions, employer-employee relations, employee morale and employee performance are included in this category. Specific prior written approval is required for all costs in this category.

(VIII I 14)

a Allowable Costs.

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

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

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

b Unallowable Costs.

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

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

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

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

(5) The costs of flowers, prizes and gifts, (but see 23 i 6);

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

(VIII I 14)

c Documentation Requirements.

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

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

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

16 Expensing Equipment and Other Property. Instead of using depreciation, an institution can be permitted to charge the program, as a direct cost, certain types of equipment and improvements at the time the items are purchased or improvement are made.

a Allowable Costs. With specific prior written approval, the program's share of the cost for most equipment and improvements purchased by the institution for use in the program can be directly expensed, but see b, below.

b Unallowable Costs.

(1) The cost of improving rental space or facilities;

(2) The cost of equipment or other property purchased by individuals;

(3) The cost of equipment or other property donated to the institution;

(4) The costs of the following under any circumstances; however, the institution's acquisition cost for these items may be depreciated (see 13, above):

(a) Buildings, additions, alterations and improvements to buildings and land;

(VIII I 16 b)

(b) General purpose equipment, including office equipment and furnishings;

(c) Air conditioning equipment;

(d) Reproduction and printing equipment;

(e) Motor vehicles; and

(f) Automated data processing equipment used for both program and general administrative purposes.

c Documentation Requirements.

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

(2) Specific transfer and disposition instructions apply when the equipment or other property has a fair market value of $5,000 or more per unit.

(3) Refer to 7 CFR Part 3016.31-.33 and 3019.30-.37, as appropriate, for additional information on recordkeeping, transfer and disposition instructions.

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

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

(VIII I 17)

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

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

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

(3) Rearrangement and Alteration. With specific prior written approval, the costs for rearrangement and alterations to facilities owned by the institution that are necessary for efficient and effective program operations but do not result in capital improvements. (See b (1), below).

b Unallowable Costs.

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

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

(3) Costs to bring either owned or rented facilities into compliance with State and local requirements except for certain costs to obtain licenses for day care homes. (See 11, above).

(VIII 17)

c Documentation Requirements.

(1) All space costs, including rearrangement and alterations, must be prorated between program and nonprogram use and the program share of the costs must be allocated between operating and administrative costs.

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

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

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

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

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

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

20 General Business Expenses. The costs of conducting the general business of an organization are unallowable. These costs include compensation (but see 23 d, below) to members, officers, directors, trustees, and associates; stipends for attendance at corporate meetings conducted pursuant to State or local incorporation requirements; costs of organization and reorganization; stock offering and stock redemption costs; and any cost incurred to meet or maintain the institution's incorporation or not-for-profit status, such as filing Federal and State income tax forms.

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

(VIII I 21)

a Allowable Costs. The costs of insurance required by the State agency that are identified in the institution's Program agreement and maintained pursuant to that Program agreement.

(1) With specific prior written approval:

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

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

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

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

b Unallowable Costs.

(1) The costs of insurance for the general conduct of the organization and the prorated share of insurance coverage costs for nonprogram activities.

(VIII I 21 b)

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

22 Interest, Fund Raising, and Other Financial Costs. This category includes interest on debt, fees and charges in lieu of interest, all fund raising costs and other financial costs, including expenses to enhance income from investments. This category does not include interest earned by the institution from program or nonprogram operations or investments. (See IX D 7, below.)

a Allowable Costs.

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

(a) With specific prior written approval:

i "Stop payment" charges for facility advance and reimbursement payments and other program disbursements, whether by check or EFT; and

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

(2) With specific prior written approval, interest incurred after October 1, 1998, for nonprofit private institutions (see A-122, Attachment B 23) and after October 1, 1980, for public institutions (see A-87, Attachment B 26), on institutional debt used to acquire or replace allowable equipment or other property or make allowable improvements. (See c, below for more information.)

b Unallowable Costs.

(1) Insufficient fund charges;

(VIII I 22 b)

(2) Bank servicing and account charges for nonprogram accounts, including the allocated share of these costs for commingled program and nonprogram fund accounts;

(3) Interest expenses in excess of the actual interest paid;

(4) Interest expenses for any debt the institution is not legally obligated to pay;

(5) Interest on debt used to acquire equipment or other property not allowable as a direct expense to the program (see 16, above);

(6) Interest on borrowed capital or the temporary use of endowment funds, however represented;

(7) Interest for reacquiring equipment or other property held by the institution or a related party through repurchase or refinancing arrangements;

(8) Credit card interest debt;

(9) Costs for failure to pay debt timely;

(10) Fees and charges in lieu of unallowable interest;

(11) All taxes and legal and professional fees in connection with financing and refinancing operations;

(12) Costs of fundraising, including financial campaigns, endowment drives, solicitation of gifts and bequests and similar expenses incurred solely to raise capital or obtain contributions;

(13) Costs of investment counsel, staff and similar expenses to enhance income from investments;

(14) All interest and principal when a less-than-arms-length financing arrangement was not fully and accurately

(VIII I 22 b)

disclosed to the State agency and FNSRO (see c, below); and

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

c Documentation Requirements for Financing Arrangements.

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

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

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

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

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

(VIII I 22 c)

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

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

i Full disclosure of the transaction;

ii A written financing document executed by a designated official of the institution and lender that includes the terms and conditions of the financing arrangement, identification of any collateral or security provided by the institution, and the nominal and effective interest rates;

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

iv The documents required in c (1)(d) above

(b) The State agency must provide FNSRO with:

i The documents submitted by the institution;

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

iii A recommendation to approve or deny the request.

(VIII I 23 a)

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

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

(1) Salaries and wages;

(2) Employment taxes and fringe benefits;

(3) Overtime compensation, holiday pay and compensatory leave;

(4) Incentive payments and awards; and

(5) Severance pay.

b Unallowable Costs.

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

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

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

(4) Retroactive salary or wage increases;

(VIII I 23 b)

(5) Compensation in any form based on the number of homes recruited;

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

(7) Costs charged to the program that do not comply with all Federal and State employment compensation and taxation requirements;

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

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

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

(11) Overtime, compensatory time or awards resulting from the institution's failure to obtain and maintain a sufficient number of qualified employees to administer the Program;

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

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

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

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

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

(VIII I 23 b)

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

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

(a) Program misconduct;

(b) Violations of Program requirements;

(c) Violation of the organization's ethics and code of conduct requirements; or

(d) Conviction for criminal misconduct.

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

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

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

c Documentation Requirements.

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

(a) Rates of pay;

(VIII I 23 c)

(b) Hours of work, including breaks and meal periods; and

(c) The institution's policy and payment schedule for regular compensation, overtime, compensatory time, holiday pay, benefits, awards, severance pay and payroll tax withholding.

(d) The compensation policy must also reflect the requirements of the US Department of Labor's FLSA for all FLSA nonexempt employees.

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

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

i Start time;

ii End time; and

iii Absences.

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

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

ii For employees with variable start and end times, the time and attendance report must be prepared daily.

iii Unless required by the institution,

(VIII I 23 c)

employees with established start and end times are not required to complete daily sign in and sign out sheets.

iv At the discretion of the State agency, daily sign in and sign out sheets may be required for employees with variable start and end times, unless prohibited by a negotiated labor-management agreement between the institution and its employees.

(3) Time distribution reports. To establish the portion of costs that may be claimed as program labor, a daily log or other time distribution method must be used.

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

(b) The portion of the labor costs charged to the program must be prorated based on the hours worked for program and nonprogram activities and within the program for administrative and operating cost labor.

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

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

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

(f) The State agency must establish the interval for time distribution reporting, however reporting intervals of less than 15 minutes are not permitted. State agencies may require different interval reporting for different positions or employees within an institution, as long as the reporting

(VIII I 23 c)

requirement does not conflict with the institution's approved cost allocation plan, OMB Circulars or applicable financial management guidance.

(g) For proprietary and nonprofit institutions, the reports must be prepared at least monthly and coincide with one or more pay periods. (See A-122 Attachment B, 7 m, for more information on nonprofit reporting requirements).

(h) For public institutions:

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

ii When an employee's compensation is charged as an indirect cost, the time distribution report requirements are determined by the approved cost allocation plan; and

iii For employees who work only on the program, certifications completed at least semi-annually can be substituted for time distribution reports. (See A-87, Attachment B, 11 (h), for more information).

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

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

(a) Employee name;

(VIII I 23 c)

(b) Employee identification number;

(c) Rate of pay;

(d) Hours worked;

(e) Benefits earned;

(f) Any reductions or increases to the employee's base compensation, i.e., overtime pay, incentive award, etc.;

(g) Gross pay;

(h) Net pay

(i) Date of payment to employee;

(j) Method of payment, i.e, check, cash, EFT; and

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

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

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

(1) Compensation to members of nonprofit institutions,

(VIII I 23 d)

trustees, directors, associates, officers, or the immediate families thereof;

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

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

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

f Employment Taxes. The employer's share of Federal, State and local employment taxes such as Social Security withholding tax and State unemployment taxes are allowed.

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

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

g Fringe Benefits. The employer's share of fringe benefit costs including vacation leave, military leave, health benefits (see (2) below), life and disability insurance (see (4 and 5) below), paid non-work holidays (see h below for additional holiday pay) and retirement benefits (see (7), below), when all like (federally and nonfederally funded) employees receive the same benefits in accordance with the established written policy of the institution.

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

(VIII I 23 g)

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

(3) The cost for an employee's, but not an officer's, individual membership in a professional organization and cost of subscriptions to professional periodicals is allowed when the individual is a recognized member of the particular profession such as Certified Public Accountant, Registered Dietitian, etc., the employee's primary work duties require practicing the profession for the institution's CACFP, the membership costs is treated as additional compensation and the State agency determines that the individual's total compensation is necessary and reasonable.

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

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

(6) An institution may pay employees for unused benefits (medical savings accounts, vacation and sick leave, etc.).

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

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

(VIII I 23 g)

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

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

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

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

(7) Consult the appropriate OMB Circulars (A-87, Attachment B 11 (e) for public institutions or A-122, Attachment B, 7 (h) for nonprofit private institutions) or the FAR (31.205-6 j for proprietary institutions) for specific requirements for pension plan costs.

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

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

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

(VIII I 23 h)

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

(a) Written documentation must be maintained that identifies:

i The specific nature of the emergency or equipment breakdown;

ii The date the event occurred; and

iii An explanation of why the event prevented obtaining prior approval.

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

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

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

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

(a) The payment is based on actual services performed by the employee or an employee suggestion that was implemented, which resulted in

(VIII I 23 i)

program cost reductions through efficient performance, improved working conditions, or a special act or achievement, such as the identification or elimination of a safety hazard;

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

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

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

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

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

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

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

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

(6) Awards of minimal value such as length of service pins, certificates of appreciation, floral arrangements, live

(VIII I 23 i)

plants, mugs, plaques or other items are allowed to the extent the employee receiving the award performed program labor. The State agency retains the right to establish a maximum cost for awards of minimal value.

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

(1) The cost of severance pay is allowed on a case-by-case basis, with specific prior written approval, when severance pay does not constitute excess compensation (i.e., golden parachute provisions) and is required by:

(a) Law;

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

(c) Established written policies of the institution; or

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

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

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

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

(b) The deferral does not represent the

(VIII I 23 k)

establishment of a contingency fund, an attempt to defer compensation as a result of an overclaim, repayment request, or funding limitation or an attempt to acquire program funds for unallowable cost purposes.

(2) Compensation costs cannot be deferred:

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

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

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

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

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

(b) The purpose of the deferral;

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

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

(e) The names of each officer and employee

(VIII I 23 k)

subject to the deferral:

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

(g) The individual officer's or employee's Federal and State income tax liabilities;

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

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

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

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

ii The officer or employees agrees to the deferral; and

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

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

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

(b) The date the funds were earned by the officer or employee, the date the funds were

(VIII I 23 k)

claimed for reimbursement and the date the funds were received by the institution;

(c) The date the funds were recorded in the restricted account; and

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

(6) Funds received for deferred salary and fringe benefits must be promptly recorded in the institution's accounting system, but no later than 5 working days after receipt.

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

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

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

(a) Fund this liability from nonfederal sources; or

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

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

(11) Amendments or modifications to approved deferral

(VIII I 23 k)

plans require specific prior written approval

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

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

24 Legal Expenses and Other Professional Services. This category includes the costs of legal and professional services performed by persons who are members of a particular profession or posse a particular skill and are not officers or employees of the institution. Additional guidance concerning legal and other professional service costs is contained in 11, above, OMB Circulars A-87, Attachment B 33, A-122, Attachment B 39 and FAR Part 31.205-33.

a Allowable Costs. With specific prior written approval:

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

(a) The amount of the funds due; and

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

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

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

(VIII I 24 a)

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

(c) The services have been properly procured;

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

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

b Unallowable Costs.

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

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

25 Lobbying and Advocacy Costs. This category includes costs for lobbying and advocacy, but not public relations (see 3, above). Except as permitted in a below, lobbying and advocacy costs are unallowable. While unallowable lobbying and advocacy costs cannot be claimed, specific reporting and disclosure requirements apply. (See c 2, below).

a Allowable Costs.

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

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

(VIII I 25 a)

Minority Member of the Committee or Subcommittee conducting such hearing;

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

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

b Unallowable Costs. All costs associated with:

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

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

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

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

(5) Legislative liaison activities, including attendance at legislative sessions or committee hearings, gathering information regarding legislation and analyzing the effect of legislation, when such activities are carried on in support

(VIII I 25 b)

of or in knowing preparation for an effort to engage in unallowable lobbying;

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

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

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

c Documentation Requirements.

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

(2) OMB Circular A-87, Attachment B, 27; A-122, Attachment B, 25 and FAR §31.205-22 should be consulted for additional information on recordkeeping and reporting requirements.

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

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

b Unallowable Costs

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

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

(VIII I 27)

27 Materials and Supplies. This category includes durable supplies and expendable materials and supplies that do not meet the definition of equipment.

a Allowable Costs.

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

(2) Costs of expendable program materials and supplies actually used within one month or less at the time of purchase; and

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

b Unallowable Costs.

(1) Materials and supplies used by the institution and individuals for nonprogram purposes.

c Documentation Requirements.

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

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

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

a Allowable Costs.

(VIII I 28 a)

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

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

b Unallowable Costs.

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

(a) Solely for non-CACFP issues;

(b) To conduct the general business of the institution (see 20, above);

(c) To engage in or prepare for prohibited lobbying activities (see 25, above);

(d) Primarily for social or entertainment activities (see 15, above); or

(e) Related to fund raising (see 3 b (3), and 22, above).

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

a Allowable Costs.

(1) Membership fees and annual dues for the institution's membership in business, technical and professional organizations related to the program;

(2) Membership fees and annual dues for one individual membership per institution in business, technical and professional organizations related to the program when the

(VIII I 29 a)

organization will only accept individual and not institutional membership;

(3) Costs for the institution's subscription to periodicals related to the program; and

(4) With specific prior written approval of FNSRO, costs of public and not for profit institution memberships in civic or community organizations.

b Unallowable Costs

(1) The costs of individual memberships in professional organizations but these costs may be allowable for employees as fringe benefits, see 23 g above;

(2) Proprietary institution membership costs in civic or community organizations;

(3) All other costs of membership in allowable organizations;

(4) Costs of individual or personal subscriptions, but see 23 g above; and

(5) All costs of membership or participation in social organizations, organizations whose primary purpose is soliciting funds for lobbying activities, or organizations devoted to lobbying.

30 Participant Training and Other Participant Support Costs. Participant training and support costs are the institution's costs for conducting training and providing a fair hearing to facilities for actions of the sponsor that adversely affect the facilities' CACFP participation or funding. Child care center and day care home personnel required to attend training who use substitute care providers may claim meals for reimbursement when the meals served by substitute care providers meet all Program requirements.

(VIII I 30)

a Allowable Costs.

(1) Training-administrative costs. With prior approval, the following administrative costs for required pre and post Program approval training of facility personnel:

(a) Rental costs of properly procured third-party meeting and conference room space;

(b) Fees for speakers, who are not employees, officers, directors or trustees or immediate family members, thereof, when the presentation is directly related to Program requirements;

(c) Costs of child care services provided for attending facility personnel;

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

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

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

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

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

(VIII I 30 a)

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

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

b Unallowable Costs.

(1) Costs for motivational speakers;

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

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

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

(5) All other participant support costs.

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

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

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

b Unallowable Costs.

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

(VIII I 32 b)

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

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

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

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

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

(2) The prorated share of direct costs when program and nonprogram purposes are benefited.

b Unallowable Costs.

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

(2) Costs for nonprogram purposes.

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

a Allowable Costs.

(1) With prior approval:

(a) Arms-length transactions for the maintenance, repair or upkeep of administrative and food service equipment that neither adds to its

(VIII I 34 a)

permanent value nor prolongs its intended life but keeps it in an efficient operating condition; and

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

(2) With specific prior written approval:

(a) All less-than-arms-length transactions;

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

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

b Unallowable Costs.

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

(2) Any share of purchased service costs for nonprogram purposes; and

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

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

36 Rental Costs. Costs in this category include lease costs for space, facilities, vehicles and equipment for use in the program. The costs resulting from less-than-arms-length transactions and lease arrangements that result in ownership interests, however represented, are limited. (See d, below.) Rental fees must be prorated between program and nonprogram use to obtain the portion that benefits the program. (See c (2), below.)

a Allowable Costs

(VIII I 36 a)

(1) Space and facilities:

(a) Private and public buildings and facilities. The institution's cost for the program share of rental costs of space in a building owned by a private third party when properly procured and a bona fide arms-length written rental agreement exists between the institution and the lessor;

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

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

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

(2) Vehicles and equipment:

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

b Unallowable Costs.

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

(VIII I 36 b)

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

(3) The prorated share of rental costs for space, facilities, vehicles and equipment used for nonprogram purposes;

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

(5) Direct rental charges when the rental costs are included in the institution's cost allocation plan as indirect costs;

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

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

c Reasonableness and Allocation Requirements.

(1) Factors in determining reasonableness.

(a) For all rental costs:

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

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

iii The benefits received by the program in relation to the cost to the program.

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

(VIII I 36 c)

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

ii The availability of commercial rental property in the area.

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

(a) Space costs.

i The rental costs must first be prorated by the ratio of the square footage of program space to:

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

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

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

iii For all prorated space costs, the State agency must establish the format, method and frequency for documenting the actual time and space used for program and nonprogram purposes.

iv For all prorated space costs, when the costs of utilities are not included in the

(VIII I 36 c)

rental fee, the costs can be charged as a Purchased Service (see 34, above) according to the same proration procedure used to charge the rental fee itself.

(b) Equipment and vehicles:

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

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

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

(1) Capital (Material equity) leases. Costs charged to the program under rental/lease arrangements that create a material equity (an ownership interest) can not exceed the allowable costs that would have been permitted had the institution purchased the item on the date the lease was executed. A material equity is created when:

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

(b) The institution has the right to purchase the

(VIII I 36 d)

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

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

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

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

(2) Sale-with-lease-back. Sale with lease back arrangements occur when an item is sold and then leased back to the seller or an affiliate of the seller. The seller may be an individual or business.

(a) Allowable lease costs under a sale-with-lease-back arrangement are limited to the amount that would result had the institution continued to own the item.

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

(a) Allowable lease costs are limited to:

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

(VIII I 36 d)

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

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

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

(a) The State agency would approve the direct expensing of the same item;

(b) The costs are prorated between program and nonprogram use;

(c) The lease agreement is not a component of a sale-leaseback or related party agreement;

(d) The terms of the lease agreement do not create a material equity in the property leased; and

(e) The costs are reasonable given the total costs that will be paid by the institution under the lease with option to purchase agreement when compared to rental without the purchase option and the costs of financing the purchase of the item.

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

(VIII I 37)

a Allowable Costs.

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

b Unallowable Costs.

(1) Personal income taxes;

(2) Corporate income taxes;

(3) Taxes resulting from nonprogram operations;

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

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

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

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

a Allowable Costs.

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

(a) Costs of transferring equipment and supplies with a residual Federal interest to the State agency or other Child Nutrition Program participant;

(b) The CACFP share of termination fees for

(VIII I 38 a)

unexpired Program space and equipment leases;

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

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

b Unallowable Costs.

(1) Non-CACFP costs;

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

(3) Costs for the loss of corporate goodwill,

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

(5) Estimated costs; and

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

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

a Allowable Costs. Costs for program travel require prior approval and may be charged on an actual, per diem or mileage basis provided that the method used results in charges consistent with those normally allowed by the institution in its nonprogram operations. The OMB Circulars and the FAR should be consulted for additional information.

(1) General.

(VIII I 39 a)

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

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

i The amount requested by the institution is unreasonable;

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

iii The State agency can not evaluate the reasonableness of the institution's established rates and travel policies because the institution administers only federally funded programs or the institution's primary source of revenue is from federally funded programs.

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

(a) Actual costs. The program share of costs for operating the vehicle including gas, oil, routine

(VIII I 39 a)

maintenance and as applicable, depreciation, use allowance or leasing fee;

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

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

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

b Unallowable Costs.

(1) The costs of personal travel;

(2) The costs of nonprogram travel including nonprogram travel incident to program travel;

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

(4) A mileage allowance when actual operating costs, depreciation, use allowance or a lease fee is charged for the same vehicle; and

(5) When a mileage allowance is charged, separate charges for fuel, insurance, maintenance.

c Documentation Requirements.

(1) For all travel and transportation costs:

(a) The date and times of day for each trip

(VIII I 39 c)

charged to the program;

(b) The traveler's name;

(c) The origin and destination of each trip;

(d) Lodging, meal and common carrier receipts, as applicable;

(e) The reason for each trip;

(f) When the trip includes program and nonprogram purposes, all nonprogram lodging, mileage and other travel costs must be identified and allocated between the program and nonprogram functions; and

(g) A responsible official of the institution must certify in writing that records documenting all travel costs and mileage claimed for program purposes have been reviewed for reasonableness and allowability.

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

(a) Mileage;

(b) Receipts for all expenses charged as actual costs;

(c) As applicable, depreciation schedules, use allowance schedules and bona fide third party lease agreements; and

(d) At the discretion of the State agency, odometer readings.

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IX BASIC GUIDELINES FOR PAYMENT AND USE OF CACFP FUNDS

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

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

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

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

B Applicable Reimbursement Methods. The CACFP regulations require that State agencies reimburse participating institutions using specific methods.

1 Day Care Home Sponsoring Institutions. Reimbursement for day care home programs is computed using two factors:

a A meal service component is computed using the number of reimbursable meals by type served to eligible participants in approved day care homes participating during the month times the applicable income eligibility based (Tiering) rate per meal; and

b An administrative cost component is computed using the lesser of net allowable administrative costs, the number of approved day care homes participating during the month times the applicable rate per home, or the approved administrative cost

(IX B 1 b)

budget. In addition, on a Federal fiscal year basis, total CACFP reimbursement payments for administrative costs cannot exceed 30% of the total administrative and meal service payments earned by the institution.

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

a The rate based reimbursement method applied to:

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

(2) The total number of meals by type served during the reporting period to eligible participants times a claiming percentage or blended rate. Please refer to FNS Child and Adult Care Food Program publications: Child Care Centers Handbook and Adult Day Care Handbook for information on claiming percentages and blended rates.

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

(1) Allowable center costs are limited to:

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

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

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

(2) Unallowable center costs for claiming and computing reimbursement include:

(IX B 2 b)

(3) Unallowable center costs for claiming and computing reimbursement include:

(a) The cost of meals that do not meet regulatory requirements;

(b) The costs of excessive second meals even when served to participants;

(c) The costs of meals served to nonparticipants;

(d) The costs of a la carte foods;

(e) The costs of meals served to nonProgram adults;

(f) All administrative and operating costs identified as unallowable in Section VIII, above; and

(g) All non-CACFP food service operating and administrative expenses.

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

3 Provider and Sponsored Facility Payments. Sponsors are required to make payments of Program funds to child and adult care centers, outside-school-hours centers and day care homes within 5 working days of receipt from the State agency (7 CFR §§226.16(g) and (h), respectively) consistent with the distribution procedures in the approved management plan.

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

(1) Write checks to the facilities for which the advance or reimbursement was claimed;

(2) Write checks to the facilities equal to the full

(IX B 3 a)

amount of the food service advance or reimbursement payment received, except for certain allowable reductions and increases (see c, below); and

(3) Issue checks to the facilities by mailing, electronic funds transfer or personal delivery within the 5 working day period.

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

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

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

(a) Liquidate facility payments;

(b) Return the amount of excess earned interest (see D 7, below); or

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

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

(4) In all cases, sponsors must establish and maintain controls that prevent the use of the facility payments

(IX B 3 b)

for any purpose other than liquidating facility payments and properly assigning earned interest as permitted by D 7, below. This includes using facility payments during the "float period" i.e., the time between when the institution receives the funds and when the checks are presented to the bank for payment; and

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

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

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

(c) If using a separate facility bank account:

The date and amount of transfers to the account, and

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

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

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

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

(IX B 3)

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

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

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

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

(4) Revised claims. A sponsor may aggregate minor amounts of a facility's payments for revised claims and issue a single check or add the amounts to the facility's next reimbursement or advance funds payment with the specific prior written approval of the State agency. The State agency may waive specific prior written approval by establishing a written policy that incorporates the State agency's definition of minor amounts, the maximum amount that can be aggregated and the timing and method for issuing the facility its aggregated payment;

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

(6) Center administrative costs. A sponsor may retain a portion of the reimbursement for its actual net

(IX B 3 c)

administrative costs in accordance with the management plan approved by the State agency. However, on a Federal fiscal year basis, the amount retained cannot exceed 15 percent of the reimbursement earned (see D 2, below for more information);

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

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

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

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

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

(1) State agencies establishing shorter deadlines for claims submission (7 CFR §226.10(e)) are not required to issue three advances before validating the reimbursement

(IX C 1 a)

claim for the first month's advance.

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

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

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

(1) Prior reimbursement claims;

(2) Fluctuations in enrollment; and

(3) Review and audit results.

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

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

(IX C 2 b)

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

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

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

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

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

b Failure to reconcile advances and earned reimbursement;

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

(IX C 3)

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

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

D Other Factors.

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

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

b Meals Served to Nonprogram Adults. Neither the costs of meals served to nonprogram adults nor the meals themselves can be claimed for reimbursement.

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

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

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

(IX D 1 b)

i When the charge for a nonprogram adult meal is less than the full cost of producing the meal, the shortage is not an allowable program cost.

ii When the amount paid for the meal exceeds the full cost of producing the nonprogram adult meal, the excess is program income and must be used in the nonprofit food service.

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

2 Center Administrative Costs.

a Sponsors of centers. The State agency must limit the amount of reimbursement payments that can be applied to administrative costs for sponsors of center programs to the lesser of 15 percent of the total reimbursement payments received or net allowable administrative costs. The State agency may waive the 15 percent limitation upon approval of the center sponsor's justification that the organization requires funds in excess of the 15 percent limitation to pay for program administrative expenses. Further, State agencies must limit the costs approved in the center sponsor's administrative cost budget to not more than 15 percent of the anticipated reimbursement payments for the budgeted period or the amount of the approved waiver. This limitation applies to sponsors of affiliated and unaffiliated centers.

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

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

(IX D 3)

costs are used to determine:

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

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

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

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

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

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

c The terms of a Federal statute, Federal regulation or the terms of a Federal interagency agreement permits charging an under recovery of costs to another Federal grant. In some institutions (Head Start Programs, for example), a priority for the use of Federal funds has been established by the Federal grantor agencies. Under this type of priority, CACFP funds are used first in meeting the institution's food service costs, while the other Federal agency's grant funds are used to pay for any remaining food service costs. However, CACFP funds cannot be used to pay for the same cost funded with the other Federal agency's funds.

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

(IX D 6)

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

(1) Program income is limited to:

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

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

(c) Revenue from nonprogram operations when a separation of program and nonprogram food service is not appropriate;

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

(IX D 6 a)

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

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

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

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

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

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

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

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

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

(IX D 6 c)

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

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

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

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

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

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

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

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

7 Interest. Interest can be earned on advance and reimbursement funds. Different requirements apply to the interest earned on reimbursement and advance funds. Different requirements also apply when interest is earned on advance funds by public and not for profit institutions.

a Reimbursement. For all institutions, interest earned on

(IX D 7 a)

reimbursement, including facility pass through funds, is other income to the program and must be recorded and used consistent with 6 (b & d) above.

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

(1) Public institutions. Public institutions may retain up to $100, per Federal fiscal year (7 CFR §3016.21(i)), in interest earned on advance funds; however, the interest is income to the program. Except for public institutions participating in a ROAP state, any interest earned in excess of $100 annually must be remitted to the State agency and the State agency must remit the amount to FNSRO. Public institutions participating in a ROAP state must remit interest earnings in excess of $100 to the address in (2), below.

(2) Not for profit institutions. Not for profit institutions may retain up to $250, per Federal fiscal year (7 CFR §3019.22(k)(3)), in interest earned on advance funds; however, the interest is income to the program. Currently, any interest earned in excess of $250 annually (or more than $100 annually for public institutions participating in a ROAP state) must be remitted to:

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

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

a Allowable. The following can be used to secure loans:

(1) Sponsor administrative reimbursement payments;

(IX D 8 a)

(2) Reimbursement payments for affiliated centers; and

(3) Equipment and other assets that have no current federally funded interest.

b Unallowable. The following can not be used to secure loans under any circumstances.

(1) Advances of administrative, food service or center funds. These funds are made available to carry out a specific purpose and may only be used for that purpose. Advance funds remain the property of the Federal Government until used for the specific purpose for which the funds were provided;

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

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

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

(a) The loan, in whole or in part, is for nonprogram purposes,

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

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

9 CACFP Close Out Procedures. Institutions are eligible to receive payment for the necessary and reasonable costs of ceasing CACFP participation (See VIII, I 38, above). Whether an institution voluntarily (for convenience) or

(IX D 9)

involuntarily (for cause) ceases CACFP participation, the State agency and the institution must make every effort to minimize CACFP close out costs. Close out costs that exceed the regulatory CACFP funding limitations are eligible for reimbursement consistent with the provisions of this Instruction. Individual facility close-out costs are not eligible for funding in excess of the institution's maximum regulatory earned reimbursement.

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

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

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

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

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

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

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

(IX D 9 a)

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

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

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

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

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

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

(b) The State agency may establish shorter time frames to permit the State agency to submit the reports required by 7 CFR §3016.50(b)). See A-122, Attachment B, item 52, and 7 CFR Parts 3016 and 3019, Subparts D for more information on reporting close out costs.

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

(IX D 9 b)

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

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

(b) Operating cost offsets-Independent centers and affiliated sponsored centers. Close out cost payments for operating costs must be offset by outstanding operating cost overclaims and unearned operating cost advances for independent centers and sponsors of affiliated centers.

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

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

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

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

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

(IX E 1 a)

taken at the point of service, for each meal service.

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

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

b Adult Meals.

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

(2) Nonprogram adults. Child and adult care centers and outside-school-hours care centers must record the number of meals served to nonprogram adults.

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

(1) Program age requirements;

(2) Not enrolled for care;

(IX E 1 c)

(3) Provider's own children that are not income eligible; or

(4) Exceed the licensed capacity of the day care home or center.

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

a Name of the sponsored center or day care home;

b Sponsored center or day care home identification number or other unique identifier used by the sponsor;

c Meal counts and, when applicable, cost data identified with the date the information was received from each sponsored center or day care home;

d The amount and date of advance funds requested on behalf of the sponsored center or day care home, including the month of the request or subsequent amended request;

e The amount and date of advance funds received from the State agency on behalf of the sponsored center or day care home with an explanation of any differences between the amount requested and the amount received and separate identification of the amount and date by original and amended claims;

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

(IX E 2 f)

the sponsored center or day care home for each original and amended claim;

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

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

i The check number or other disbursement method used to issue each advance and reimbursement payment to the sponsored center or day care home; and

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

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

3 Financial. Institutions must record the receipt and expenditure of all program funds, program income and other income in accordance with GAAP, this Instruction, Department regulations and the State agency financial management system.

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X FOOD DONATION

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

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

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

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

Day care home sponsors that receive entitlement commodities for distribution to some but not all participating homes must establish procedures and maintain records to ensure that the reimbursement payments to the day care homes receiving the entitlement commodities are reduced by the value of the commodities received.

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

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

D Donated Food Processing. When costs of processing entitlement or bonus donated foods into different end products are paid by the institution, these charges can be included as program food costs. In addition, when the costs of distributing, transporting,

(X D)

storing and handling these end products are not included in the charges for the end products, these costs can be included as program food costs.

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

XI IMPLEMENTATION

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

XII OFFICE OF MANAGEMENT AND BUDGET APPROVAL

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

STANLEY C. GARNETT
Director
Child Nutrition Division
Attachments

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GLOSSARY

Terms used in this Instruction are those included in 7 CFR §226.2, 7 CFR Part 3016 and 7 CFR Part 3019. Where the term State agency is used, it should be interpreted to include the phrase "or FNSRO, where applicable."

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

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

B Administrative costs are incurred by an institution for planning, organizing and managing a food service under the CACFP; and allowed by this Instruction.

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

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

E Bonus commodities are a group of USDA donated foods that are not charged against a State agency's or recipient's donated food entitlement.

F Compensatory time is paid leave granted in lieu of a cash payment for overtime or holiday work.

G Cost means an amount determined on a cash, accrual or other basis acceptable to awarding agency. It does not include transfers to a general or similar fund.

H Depreciation is the expense associated with the use of nonexpendable equipment, vehicles and facilities owned by the institution. Depreciation does not result in a reduction in the cash balance of an institution.

I Direct costs are those that can be identified specifically with a particular cost objective.

J Direct expensing means the costs to acquire nonexpendable personal property or make modifications or repairs that materially increase the value or service life of nonexpendable personal property that are charged as an expense in the period the property is acquired or the repair is made, instead of depreciating the cost over the property's useful life. Direct expensing is also called a capital expenditure.

K Durable supplies are items having a life expectancy of more than one year and an acquisition cost of the lower of $5,000 per unit or the institution's definition of equipment.

L Equipment is an item of nonexpendable personal property with a useful life of more than 1 year and an acquisition cost of $5,000 or more per unit. When an institution has a more conservative definition for equipment, the institution must use that definition when applying this Instruction.

M Expendable personal property is all tangible personal property other than nonexpendable personal property.

N Financial management is directed to the effective control over and accountability for all funds, property and other assets to assure that they are safe-guarded and used efficiently to fulfill authorized purposes. Financial management includes such activities as budgeting, costing standards, internal control, management of revenues and expenses, management of property, procurement standards and fiscal audits. Records of these activities must be supported by source documents that accurately and completely disclose the sources and uses of funds.

O Food service management company is an organization, other than a public or private nonprofit school, with which the institution contracts for preparing and, unless otherwise provided, for delivering meals with or without milk for use in the program.

P Generally Accepted Accounting Principles are rules and procedures that govern accounting for financial transactions. Generally accepted accounting principles are derived from a variety of sources, including the Financial Accounting Standards Board and its predecessor, the Accounting Principles Board, and the American Institute of Certified Public Accountants.

Q Holiday pay is earned by an employee for work performed on a recognized holiday that is customarily a non-work day for the institution's employees.

R Indirect costs are incurred for a common or joint purpose and are not readily assignable to those purposes without a disproportionate amount of effort. Indirect costs assignable to the CACFP can benefit both operating and administrative functions. See OMB Circulars A-87 and A-122 for more information on indirect costs.

S Inventory adjustment is an upward or downward correction to the inventory. The adjustment may be identified during the reconciliation of the recorded (book) inventory with the physical count of the inventory. Adjustments may result from errors that were recorded in a previous inventory or the loss of goods resulting from theft, fire, water, refrigeration breakdown or product contamination. The adjustment must be supported by written records identifying the amount and cause for the adjustment. The records for adjustment should be prepared by the person responsible for safekeeping the inventory. Inventory adjustments should be made to the ending inventory balance and should be approved by a responsible institution official. Upward adjustments in the inventory must be used to reduce the costs charged to the program.

T A less-than-arms-length transaction is one under which one party to the transaction is able to control or substantially influence the actions of the other(s). Such transactions include, but are not limited to, those between divisions of an organization; organizations under common control through common officers, directors or members; and an organization and a director, trustee, officer, key employee of the institution or immediate family, either directly or through corporations, trusts or similar arrangements in which a controlling interest is held. All less-than-arms-length transactions require specific prior written approval.

U Nonexpendable personal property is all property with a useful life of more than 1 year and an acquisition cost of $5,000 or more. Nonexpendable personal property can be tangible, having physical existence, such as equipment, or intangible, having no physical existence, such as patents, inventions, and copyrights. When an institution has a more conservative definition for nonexpendable personal property, the institution must use that definition when applying this Instruction.

V Nonprofit food service includes all food service operations conducted by the institution principally for the benefit of enrolled participants, from which all of the Program reimbursement funds are used solely for the operation or improvement of that food service. Food service account activity must be monitored to determine nonprofit food service status for institutions.

W Nonprogram adult is an adult, who is not a CACFP participant, who does not performs program labor on the day a meal is served to him or her.

X Operating costs are the expenses incurred by an institution in serving meals to participants under the Program and allowed by the State agency financial management system.

Y Overtime compensation is earned by an employee for work performed in excess of the employee's regular work schedule. The compensation may be paid at a higher rate or may be paid at the employee's regular rate of pay.

Z Participant is an eligible child or adult, as defined in 7 CFR 226, who participates in the CACFP.

AA Personal property is property of any kind except real property. It may be tangible or intangible. Personal property is classified as either nonexpendable or expendable.

BB Program, when capitalized (Program), means the CACFP specifically. When lower case, program means the food service conducted primarily for the benefit of enrolled participants.

CC Program costs are allowable costs, both operating and administrative, that are necessary and reasonable for proper and efficient operation of a food service that includes the CACFP.

DD Program adult is an adult employee or volunteer, but not a CACFP participant, who performs program labor on the day a meal is served to him or her.

EE Prior approval means securing the State agency's permission to incur costs.

FF Prudent person is a standard used to evaluate whether a sensible person exercising due care would spend the same amount of money on the item or activity in question.

GG Real property is land, including land improvements and structures, excluding movable machinery and equipment.

HH Related party transaction is a transaction between the institution and its parent corporation, corporate divisions, subsidiaries, an employee(s), officer(s), agent(s) of the institution or members of their immediate family either directly or indirectly

through corporations, trusts or similar arrangements in which they hold a controlling interest, no matter how represented. All related party transactions are less-than-arms length transactions.

II Shared costs are direct costs that benefit more than one cost objective and can be readily prorated to the objectives benefited. Shared costs are also referred to as joint costs.

JJ Specific prior written approval means securing the State agency's or, in some cases, FNS' permission in advance to incur costs. Except in cases of emergencies, this permission must be in writing.

KK Suppliers are public organizations, private commercial enterprises or individuals with which the institution contracts. Suppliers are also referred to as vendors.

LL Supplies are items of personal property other than equipment and real property. Supplies are also referred to as expendable personal property.

MM Termination is the permanent withdrawal of authority to participate in the CACFP. Termination includes voluntary withdrawal.

NN Unaffiliated center is a participating sponsored child or adult care center that is legally distinct from its sponsoring organization.

OO Unfunded cost is the difference between the amount of cost incurred and the funds available to pay the cost.

PP Use allowance is used to recognize the value of useful properly that has been fully depreciated on the institution's books before being placed into service in a Federally funded program The maximum annual use allowance for buildings and improvements is 2 percent. For equipment, it is 6 $^{2/3}$ percent.

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FOOD COST

All institutions and facilities, other than day care homes and sponsoring organizations of day care homes, must compute the cost of food used in the program.

A Cost of Food. The cost of food is the net cost of food purchases and the net cost of delivered meals and foods.

1 Net Food Costs. The cost of food and meal purchases must be net of all applicable reductions and unallowable costs. All reductions must be documented and subtracted when computing net food costs.

a Cost reductions include returns to suppliers, credits, allowances on invoices for unacceptable food, cash discounts and rebates.

b Unallowable costs include:

(1) Foods purchased for catering and vending operations;

(2) The cost of foods or meals purchased only for adults not participating in the program;

(3) The cost of foods or meals not meeting specifications;

(4) The cost of foods or meals not properly procured;

(5) The cost of meals missing a component;

(6) Spoiled meals or foods; and,

(7) The value of donated foods. (See B below for more information.)

B Allowable Food Costs. Allowable food costs are the net price of the purchased and vended foods and meals used in the program. Costs associated with the receipt, storage and use of USDA donated foods are allowable, but the value of donated foods is not. See X, above and E, below for more information.

1 Food Purchases. Since allowable food cost is determined by the net cost of food used and not the cost of all food purchased, food purchases must be reconciled to the cost of the food actually used. The Purchase Method or the Inventory Method or both is used to determine the costs of purchased food used. The reconciliation of food purchased to food used must be conducted at least annually, but State agencies can require more frequent reconciliation, i.e., monthly, quarterly or semi-annually.

a Purchase Method. This method is appropriate for perishables, such as fresh produce and dairy products, or when food inventories are not maintained because food is purchased and used almost immediately. The cost of food used is calculated by summing the net price for each item purchased during the period.

The following information for each item purchased is needed to compute the net price of the food used. Exhibit E provides a suggested format that can also be used.

(1) The name of the item;

(2) The date of the purchase;

(3) A description of the purchase unit (cans, half-pints, pounds, cases, etc.);

(4) The number of units purchased;

(5) The gross price per unit;

(6) Any price reductions; and

(7) The net price (5-6).

b Inventory Method. The inventory method computes the difference between the beginning inventory, the value of foods added to inventory during the period and the ending inventory. When inventories are maintained, a physical count of food in the inventory must be conducted to accurately compute the cost of food used. (See (2) below for more information.)

(1) Assigning inventory values. In calculating the value of an inventory, the first-in, first-out method should be used. Under this method, the oldest item of a product in

the inventory and its cost is considered to be the first item of that product that is withdrawn from the inventory. While first-in, first-out reflects good inventory management practices, it does not mean that the oldest item is actually used first, but it does represent a method for assigning a cash value to the items in inventory. Any other method of valuing the inventory requires specific prior written approval.

(2) Physical inventory. The physical inventory is required for the Federal fiscal year end closeout of each institution's program activities and must be conducted at least annually. State agencies may establish more frequent physical inventory requirements. Exhibit G, attached, has a sample format that can be used for reconciling the results of the physical inventory, while Exhibit H, also attached, may be used for recording inventories.

(a) Inventory adjustments. Adjustments must be made to the inventory for changes resulting from miscounts, fire, water damage or spoilage. Records of major (more than $100 annually) inventory adjustments showing the same information as the inventory records must be maintained. Recording minor increases and reductions as an inventory adjustment is not required.

(b) Insured inventory losses. Records of insurance claims and collections for insured inventory losses must be maintained. An inventory adjustment is not required for the amount of a nominal insurance deductible applied to an inventory loss. The deductible is separate and distinct from minor reductions in inventory.

(c) Uninsured and other inventory losses. All other losses are unallowable costs, including the costs of losses that could have been covered by insurance.

(3) Formula. The following formula can be used when a food inventory is maintained.

1	Value of beginning inventory (Date)		$_____		
2a	Total cost of food purchased	$_____			
2b -	Reductions (Credits, returns and rebates)	$_____			
2c =	Net Cost of Food Purchased		$_____		
3	Food Available (1 + 2c)			$_____	
4 -	Ending inventory (Date)			$_____	
5 =	Cost of Food Used (3-4)				$_____
6a +	Upward inventory adjustments	$_____			
	or				
6b -	Downward inventory adjustments	$_____			
6c =	Inventory adjustments		$_____		
7 =	Net Cost of Food Used (5 + or - 6c) [Date]				$_____

2 Net Allowable Vended Meals/Food Costs.

a Unitized Meals. When unitized meals are delivered, the net allowable cost of food used is the greater of:

(1) The number of meals meeting program requirements that were ordered and received; or

(2) The number of program meals actually served.

(3) When excess meals are held over for service on the following day, the cost of the meals can only be claimed once, either on the day of receipt or the day of service.

b Vended Food Deliveries. The allowable net cost for vended (bulk) food is the greater of:

(1) The amount of eligible food ordered and received; or

(2) The amount used in the program meals actually served.

(3) When excess foods are held over for service on the following day, the cost of the foods delivered can only be claimed once, either on the day of receipt or the day of service.

C Nonprofit Food Service Costs. In all States, the net costs of purchased foods used or meals served to participants are allowable nonprofit food service account costs. However, total allowable food costs must be adjusted in States that use cost based reimbursement to determine reimbursable food costs.

1 Cost Based Reimbursement. For purposes of claiming reimbursement in States that use cost based reimbursement, Program food costs for self prep programs are the net costs of the food purchases that were actually used in meals served to eligible participants and Program adults. For vended programs, Program food costs are the costs of meals actually served to eligible participants and Program adults.

D Required Documentation. Records of the cost and quantity of food purchased, cost reductions, and amount of food used must be maintained.

1 Food Purchased. Required food cost records include:

a Procurement documents, including bids and contracts;

b Purchase orders;

c Delivery receipts;

d Invoices;

e Canceled checks;

f Itemized cash receipts;

g Purchase records;

h Cost records for transporting, storing, handling and processing that are not included in the purchase price;

i Credits, returns and rebates; and

j Inventory records.

2 Purchased Meals and Food Obtained from Schools, Institutions or FSMCs. Required records include:

a Procurement documents, including bids, requests for proposals and contracts;

b Order forms;

c Delivery notices signed by a designee of the institution verifying:

(1) The itemized number of meals of each type delivered;

(2) For bulk deliveries, the type and amounts of food included in each delivery; and

(3) The number or amount of any missing, spoiled or rejected meals or foods.

a Records of returns, allowances, cash discounts taken, refunds, rebates and other credits when the credit is not shown on the invoice or delivery notice; and

b Canceled checks or other payment receipts.

3 Other Records.

a Menu records that identify the meal components served to participants must be maintained. Menu records must be updated to reflect changes to planned menus so that the menu records reflect the actual meal components and foods service to participants.

b Food production records showing the quantity of food prepared are suggested and can be required by the State agency.

E USDA Donated Foods. Allowable costs include transporting, storing, handling and processing USDA donated foods.

1 Centers. For centers, these costs are allowable program food costs.

2 Sponsors of day care homes.

a With specific prior written approval, the sponsor may:

(1) Claim as administrative costs, the reasonable and necessary costs for distributing and processing donated commodities when these costs are not charged to the day care home provider (§226.(f)(3)); or

(2) With the written consent of the day care provider, (§226.18(b)(7)), incur the costs of distributing and processing donated commodities and deduct these costs from the Program payments to the day care home provider.

b Although prior State agency approval is not required, sponsors that absorb all donated food distribution and processing costs without charge to either the day care home provider or administrative costs should inform the State agency of this decision.

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INDEX

The following index is a quick reference tool for information contained in this Instruction. Readers should refer to the Instruction for additional information. Unless noted, items are found in Section VIII, I. **PLEASE NOTE**: The following captions do not convey approval of any cost or component of cost.

SUBJECT	ITEM	PAGE
A		
Accounting – Other	1	19
Accounting – Program	1	19
ADP Purchases – Program Use	16	33
ADP Purchases – Shared Use	16	34
Adult Meal Costs	IX, D, 1	90
Administrative Costs-Centers	IX, D, 2	91
Advance Payments	IX, C	87
Advertising – Other	3	20
Advertising – Procurement & Recruitment	3	20
Air Conditioning Equipment - Purchase	16	34
Appeal Costs - CACFP	2	19
Appeal Costs - Other	2	19
Audits - Organization wide	4	21
Audits – Other	4	21
Audits – Program specific	4	21
Awards – Employees	23	52
Awards – Minimal value	23	53
Awards – Other	23	42
Awards – Prospective	23	43
B		
Bad debts	5	22
Board member compensation	23	43, 48
Board member travel costs	23, 39	44, 76
Bonding - Condition of eligibility	6	22
Bonding – Other	6	23
Bonding – Program funds	6	22

SUBJECT	ITEM	PAGE
C		
CACFP Close-out costs	38	75
CACFP Close-out procedures	IX, D, 9	97
Capital Leases	36	72
Cash out benefit plans	23	50
Cellular telephones	8	23
Collateral	7	23
Commuting to and from work	39	78
Compensatory leave	23	51
Contingencies	9	23
Contributions to others	10	24
Costs - Generally Allowable	VIII D	17
Costs requiring prior approval	VIII E	17
Costs requiring specific prior written approval	VIII F	17
Costs to maintain nonprofit status	20	36
Criminal and civil proceedings	11	24
D		
Deferred compensation	23	54
Depreciation	13	29
Donations made to others	10	24
Donations received	10	24
E		
Equipment Purchases - Other	16	33
Equipment Purchases - Program use	16	33
Equipment rental	36	68
Employee morale, health and welfare	14	31
Entertainment	15	33
F		
Facilities and space acquisitions	16	33
Facsimile costs	8	23
Family health plan costs	23	49
Financing/refinancing costs	22	38
Fines and penalties	18	36
Food cost	Exhibit B	
Fringe benefits	23	49

SUBJECT	ITEM	PAGE
Fund raising	22	38
G - H		
General business expenses	20	36
Generally allowable costs	VIII D	17
Golden parachute payments	23	44
Holiday pay	23	51
I		
Income to the program	IX D 6	92
Individuals not employed - Compensation	23	42
Insufficient funds (Bounced) check charges	5, 22	22, 38
Insurance deductibles	21	37
Insurance premiums - Corporate liability	21	37
Insurance - Employee fringe benefit	23	49
Insurance - Officers, directors, etc.	23	48
Insurance - Organization is beneficiary	23	42
Internet services	8	23
Interest earned	IX D 7	95
Interest Paid- Credit cards	22	39
Interest Paid - Equipment acquisitions	22	38
Interest Paid - Related party transactions	22	38
Interest Paid - Space and facility acquisitions	22	38
J - K		
Janitorial services	34	68
L		
Labor costs	23	42
Laptop computers less than $5,000 per unit	27	62
Laptop computers more than $5,000 per unit	16	33
Late payment charges	5	22
Legal expenses	24	58
Legal expenses - CACFP appeals	2	19
Legislative costs	31	66
Less than arms length leases	36	73
Licensing standards - day care home	12	27
Licensing standards - Other	12	27

SUBJECT	ITEM	PAGE
Loan Security	IX D 8	96
Lobbying	25	59
Losses	5	22
M - N		
Maintenance costs	34	67
Management studies	26	67
Material equity (Capital) leases	36	72
Maximizing CACFP funding - Labor costs	23	43
Meal Service Records	IX E 1	100
Meeting and conferences - Joint purposes	28	63
Meeting and conferences - Other	28	63
Meetings and conferences - Program	28	62
Membership dues – Other	29	64
Membership dues – Professional groups	29	63
Messenger services	8	23
Mileage allowances	39	78
Motivational speakers	15, 30	33, 66
O		
Option to purchase leases	36	74
Overclaims	5	22
Overtime compensation	23	51
P		
Pagers	8	23
Parking costs	39	40
Parking tickets	18	36
Participant costs - Other	30	66
Participant costs - Training	30	65
Payroll records	1, 23	19, 47
Personal use property	23	44
Political and partisan costs	31	66
Postage	8	23
Printing	33	67
Prior approval	VIII E	17
Professional costs - CACFP appeals	2	19
Professional organization memberships	23, 29	50, 63

SUBJECT	ITEM	PAGE
Professional services - Nonprogram	24	58
Professional services - Program	24	58
Program funds integrity	IX B 3 b	84
Program income	IX D 6 a	93
Proposal costs	32	66
Publication costs	33	67
Public relations - Other	3	20
Public relations - Program	3	20
Purchased services	34	67
Q-R		
Rearrangement/Alterations - Major	13, 17	29, 34
Rearrangement/Alterations - Minor	17	29
Reconciliation of payments	IX E 2	100
Records retention	35	68
Reimbursement-General Information	IX B	81
Related party transactions - Disclosure	VIII B	16
Rental - Equipment	36	69
Rental - Personally leased property	36	69
Rental - Private residence	36	69
Rental - Privately owned facilities	36	69
Rental - Publicly owned facilities	36	69
Rental - Vehicles	36	69
Reorganization costs	20	36
Retroactive salary/wage increases	23	42
S		
Salaries and wages	23	49
Sale with lease back	36	73
Self insurance	21	36
Service maintenance contracts	34	68
Severance pay	23	54
Social functions and events	15	33
Special assessments - Capital improvements	37	74
Specific prior written approval	VIII F	17
Subscription costs	29	64
Supplies	27	62

SUBJECT	ITEM	PAGE
T		
Taxes - Corporate Income Tax	37	75
Taxes - Employee share	23	43
Taxes - Employer share	23	49
Taxes - Other	37	73
Telephone	8	23
Termination costs	38	75
Training - Costs of meals (Participant Training)	30	65
Training - Participant	30	64
Travel - Nonprogram incident to program	39	78
Travel - Program	39	76
U - V		
Use allowance	13	29
Vehicles - Personnel use	23	44
Vehicles - Purchase	16, 27	34, 62
W - X - Y - Z		

SUGGESTED FORMAT FOR RECORDING
EQUIPMENT AND DEPRECIATION
PERMANENT RETENTION

A	B	C	D		E	F
Date Placed in Service	**Description (Including model & serial numbers)**	**Acquisition Cost**	**Depreciation Method & Life Expectancy**		**Depreciation Amount**	**Status & Disposition**
			Method	**Life Expectancy**		

Instructions

This format can be used for property management purposes and for computing and recording depreciation.

A. Record the date the item was purchased. If the item was placed into actual use after the date of purchase, identify the purchase date and the date the item was placed into service which is the effective date for depreciation.

B. Self-explanatory.

C. Include the purchase price, delivery, set up charges, and any in-transit insurance. DO NOT INCLUDE any financing or interest charges. Identify, record, and deduct the amount and source of any Federal funds used to pay for all or any portion of the item's cost or to meet a matching of a Federal grant from the acquisition cost. Deduct any refunds, rebates, and prompt payment discounts received. If the item was received as a result of a trade or a trade-in was used, deduct the amount received for the traded item from the adjusted acquisition cost of the new item, then add back the lesser of: (1) the nonfederal share of the fair market value, (2) undepreciated nonfederal share of the original item or (3) nonfederal share of the trade-in.

For donated equipment or when the acquisition cost is not known, use the current fair market value of the item at the time of donation. Only the costs incurred in obtaining and placing donated equipment into service may be depreciated.

D. Identify the depreciation method that will be used (i.e., SL, DDB, etc.) and the number of years that the equipment is expected to be depreciated (e.g., SL for 5 years).

E. For the annual amount using the SL method, divide column C by column D, Life Expectancy. For a monthly depreciation amount, divide the annual amount by 12. Record the depreciation amount and indicate whether the amount is yearly or monthly. For methods other than SL, make the necessary calculations, enter the amount, and indicate whether the amount is monthly or yearly in column E. Depreciation must be recomputed each year for all depreciation methods other than SL or whenever capital improvements to equipment are made, regardless of the depreciation method used.

F. Record the current location of the item, its condition, current use, and the date this information was recorded. Record how and when (date) the item was taken out of service, sold, disposed of, or traded. Update this information annually.

NOTE: A biennial physical inventory is also required for items funded with Federal funds or used to meet a Federal matching requirement. Maintain the results of the physical inventory with this format. Depreciation and physical inventory records must be retained permanently.

SUGGESTED FORMAT FOR THE COST OF GOODS USED

For the Period Beginning_____ Ending_____

Circle One:

Food Nonfood Supplies Office Supplies

A. Beginning Inventory Value		$ _____
B. Total Purchases During the Period	+	_____
C. Adjustments	+ -	_____
D. Total Available	=	
E. Ending Inventory	-	_____
F. Cost of Goods Used	=	$ _____

Instructions

Use the information from Exhibits F and H to complete this format. When a physical inventory was conducted, also use the information from Exhibit G.

A. Record the Beginning Inventory Value from Exhibit H.

B. Record the Total Net Purchases from Exhibit F.

C. Add or subject inventory adjustments from Exhibit G

D. Add lines A and B and record the results.

E. Record the Ending Inventory from Exhibit H or the adjusted ending inventory.

F. Subtract line D from line C and record the results.

SUGGESTED FORMAT FOR A PURCHASE RECORD

Circle One:

Food
Food Service Supplies
Office Supplies
Other (Describe):_____

A	B	C	D	E	F	G
Date	**Item**	**Purchase Unit**	**Quantity Purchased (in Units)**	**Unit Cost**	**Discounts/ Refunds**	**Total Cost**

H. **Total Net Purchases** **$** _____

Instructions

Use this format to record purchase information.

Use a separate format for each major category of purchases during the accounting period. Circle the appropriate category (e.g., food, office supplies, etc.).

Use invoices, sales receipts, etc., to determine the entries for columns A, B, C, D, E, and F.

A. Record the date of purchase.

B. Describe the item.

C. Record the purchase unit in whole numbers only. When less than whole cases are purchased, record the individual unit. For example, the purchase unit for 1½ cases of peas would be cans.

D. Record the total number of units purchased, i.e., 1½ cases of peas (24 cans to a case) would be recorded as 36 cans.

E. Record the gross price per unit before any refund, rebate, or discount is taken.

F. Record the total (not unit) refund, rebate, or discount.

G. Multiply column D by column E, then subtract column F. Record the results.

H. Add column G to determine the total net value of purchases during the period.

When a significant supply of a nonperishable purchased item is still available for use at the end of the accounting period, the cost of purchases should be reduced by the value of this remaining balance and the balance should be transferred to the inventory record (Exhibit H).

SUGGESTED FORMAT FOR INVENTORY RECONCILIATION

Circle One:

Food
Food Service Supplies
Office Supplies
Other (Describe):_____

For the Period Ending:_____

A	B	C	D	E	F	G
Item	**Physical Inventory Balance**	**Recorded Ending Balance**	**Difference (B—C)**	**Unit Price**	**$ Net Difference**	**Explanation**

H. Total Inventory Adjustment $ _____

Instructions

Use this format to reconcile inventory differences between the physical inventory and the book inventory.

Use a separate format for each major category in the inventory. Circle the appropriate category (e.g., food, office supplies, etc.) and enter the last day of the inventory period that is to be reconciled. After the reconciliation is completed, the book inventory must be adjusted to reflect the results of this reconciliation.

A. Record the item name.

B. Record the balance determined by the physical inventory for the item.

C. Enter the amount (Balance) from Exhibit G, column B.

D. Subtract column C from column B. Identify whether the difference is a shortage (-) or a surplus (+).

E. Enter the amount (Unit Price) from Exhibit G, column C.

F. Multiply column D by column E and record the results. Record the same sign (+ or -) used in column D.

G. Self-explanatory.

H. Add column F to determine the amount of the net inventory adjustment.

SUGGESTED FORMAT FOR AN INVENTORY RECORD

Item:_____

Beginning Inventory:_____

A	B			C	D
Date	Quantity (Cases, cans, pounds, etc.)			Unit Price	Value of Ending Balance
	Received	Withdrawn	Balance		

E. Total Value of Ending Inventory $ _____

Instructions

Use a separate format for each major inventory category or specific inventory item.

Record the name of the inventory category (i.e., food, nonfood supplies, office supplies, or specific item) on the line provided.

Record the beginning inventory value.

A. Record the date of each receipt and withdrawal to the inventory.

B. Record the quantities received or withdrawn from the inventory using whole numbers. For example, 1½ cases of canned peas should be recorded as 36 cans. For withdrawals, the first-in/first-out method should be used. This means that the items added to the inventory first should be recorded as used first.

C. Use invoices, sales receipts, or column E of Exhibit F and record the unit price.

D. At the end of the accounting period, multiply any amount under column B (Balance) by column C and enter the results.

E. Total all entries in column D to determine the ending inventory value. This amount will become the beginning inventory value for the next accounting period.