MEMORANDUM

TO: Vice Presidents, Chancellors, Deans and Directors
Administrative and Fiscal Officers
Principal Investigators

FROM: Kevin Hanaoka
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SUBJECT: Impact of Recent Federal Policy Changes on Revolving Funds that Bill Federal Agreements for Services

On May 10, 2004, the Office of Management and Budget issued final policy revisions to OMB Circular A-21, “Cost Principles for Educational Institutions.” One of the major revisions requires that billing rates for revolving funds must be adjusted at least every two years and that surplus or deficit balances must be taken into consideration. The prior rule was vague and seemed to imply that balances could be carried forward for an indefinite period of time.

The impact of this change means that at the close of FY 2005, revolving fund managers must consider whether to raise rates to eliminate deficits or lower rates to eliminate surpluses. This exercise must then be repeated at the close of FY 2007 and every two years thereafter.

The following guidelines should be applied to revolving funds that bill federal agreements and non-federal agreements. Federal agreements include:

- Grants, contracts or other agreements between federal agencies and the University to conduct research, training or other activities; or
- Subcontracts from non-federal entities (e.g., collaborating university, research institute, State agency or other non-profit organization) that uses federal monies to pay for the University’s scope of work; or
- RCUH direct projects that use federal monies to pay for the scope of work conducted by or on behalf of the University.

Guidelines

1. Every two years, revolving fund managers must decide whether to increase rates to eliminate a deficit or lower rates to eliminate an excess surplus. It is recommended that revolving fund managers should at least perform an analysis at the end of each fiscal year to minimize large deficits or surpluses that might occur.
2. Deficit balances may no longer be carried forward for an indefinite period of time. The revolving manager may elect to amortize the deficit over three to five years to minimize the impact on the rates. However, a deficit requiring more than five years to amortize should be written off against departmental funds.

3. Surplus balances should be treated as follows:

**Working Capital.** According to the Compliance Supplement to OMB Circular A-133, "Audits of States, Local Governments and Other Non-Profit Organizations," a revolving fund may retain a portion of the surplus to cover working capital needs of the fund, but no more than a maximum of 60 days of normal cash expenses. Examples of normal cash expenses include:

- Salaries and fringe benefits of revolving fund personnel
- Consumable supplies
- Monthly rental costs
- Monthly utilities
- Items that must be prepaid (e.g., maintenance agreement due in July)

**Non-Working Capital.** Surplus balances may not be retained for equipment purchases, capital expenditures (e.g., major renovations) or debt service. Amounts may be set aside for equipment replacement only if the billing rate(s) include a cost component for equipment depreciation. Note that federally funded equipment does not qualify for depreciation because we cannot recover the cost of items paid for with federal funds.

**Transfers.** In addition, transfers may not be made out of the fund unless they are for operating expenses (See examples of normal cash expenses). Thus, any transfer for non-operating purposes is subject to refund to the Federal Government.

**Excess Surplus.** If there is an excess surplus balance, after taking into account working capital needs and operating transfers, that balance must be considered in setting rates. A balance of more than 5% of total annual operating costs should result in the lowering of billing rates to bring the excess surplus to a manageable 5% or less of total operating costs.

Because the treatment of revolving funds that bill federal agreements can be complex, contact Kevin Hanaoka of the Office of Research Services at 956-7800 if you have questions on the application of these guidelines. You may also contact Gilbert Oshima of RCUH at 988-8320 for assistance.

c: James Gaines, Interim VP for Research
Michael Hamnett, Executive Director, RCUH