February 25, 2009

Honorable Joseph B. Morton
State Superintendent of Education
Alabama Department of Education
Gordon Persons Office Building
50 North Ripley Street
Montgomery, AL 36104

Reference: Proper Treatment of Retirement Incentive Payments

Dear Dr. Morton:

I am writing to alert you to recent audit findings in the area of severance costs, specifically retirement incentive payments that are provided to encourage employees to leave their employment. State and Local Education Agencies (SEAs/LEAs) may be mistakenly concluding that certain retirement incentive payments are fringe benefits that can be charged to Federal programs, rather than "abnormal or mass severance pay". As a result, some SEAs and LEAs are not obtaining the required prior approval to charge retirement incentive payments to Federal programs. Prior approval, to charge such costs, must be obtained from the US Department of Education or other cognizant Federal agency.

This letter includes information on the prior approval requirement. We request that you provide this information to (1) financial and program staff; (2) Public Agency Retirement Systems and other known administrators of retirement incentive plans; and most importantly, (3) your LEAs and subgrantees. The guidance should be incorporated in policies, procedures and practices.

The Cost Principles for State, Local and Indian Tribal Governments at 2 CFR 225 (OMB Circular A-87) establish standards for determining costs on Federal awards carried out through grants, cost reimbursement contracts, and other agreements. Attachment B of the Circular addresses selected items of cost and Paragraph 8.g. provides the criteria for Severance pay, as follows:

(1) Payments in addition to regular salaries and wages made to workers whose employment is being terminated are allowable to the extent that, in each case, they are required by (a) law, (b) employer-employee agreement, or (c) established written policy.

(2) Severance payments (but not accruals) associated with normal turnover are allowable. Such payments shall be allocated to all activities of the governmental unit as an indirect cost.

(3) Abnormal or mass severance pay will be considered on a case by case basis and is allowable only if approved by the cognizant Federal agency.

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The Department of Education's mission is to promote student achievement and preparation for global competitiveness by fostering educational excellence and ensuring equal access.
Attachment A of the Circular contains the principles for determining allowable costs. Paragraph B.1. of Attachment A explains the meaning of the phrase “approved by the cognizant Federal agency” as follows:

‘Approval or authorization of the awarding or cognizant Federal agency’ means documentation evidencing consent prior to incurring a specific cost. If such costs are specifically identified in the Federal Award document, approval of the document constitutes approval of the costs. If the costs are covered by a state/local wide cost allocation plan or an indirect cost proposal, approval of the plan constitutes the approval.

A Guide for State, Local and Indian Tribal Government provides assistance to government units in applying the principles and standards in OMB Circular A-87. This publication was issued by the US Department of Health and Human Services as the OMB Circular A-87 Implementation Guide (also known as ASMB C-10) and is applicable to grants and contracts awarded by all Federal agencies. In the Guide section titled, “Questions and Answers on Attachment B”, Item 3-13 provides the following definition of “severance pay” and reiterates the need for prior approval:

(1) Mass severance or termination benefits would include all expenses associated with the event. This would include: lump sum payments that may be linked to years of service, increased pension benefits such as granting additional years or eliminating penalties for early retirement, payments of unused leave, and the cost of any other incentive offered to employees as an incentive to leave government service, such as buy-outs.

(2) The costs of these special termination benefits must be determined and prior approval of such costs must be obtained from the Federal cognizant office prior to claiming these costs directly or indirectly against Federal programs. The requests for prior approval, at a minimum, must demonstrate the reasonableness and allocability of such costs to Federal programs.

This additional information and guidance should clarify the requirements for charging retirement incentive payments to federal awards. We will continue to share information with you on these and other emerging cost issues. If you have any questions, please contact me at (202) 377-3835.

Sincerely,

Mary Gonzales
Director, Indirect Cost Group
Financial Improvement and Post Audit Operations

cc: Mr. Kevin Rowe
Alabama Department of Education