

MAINE STATE LEGISLATURE

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STATE OF MAINE
DEPARTMENT OF ADMINISTRATIVE AND FINANCIAL SERVICES
OFFICE OF THE STATE CONTROLLER
14 STATE HOUSE STATION AUGUSTA, ME 04333-0014

EDWARD A. KARASS
STATE CONTROLLER



TERRY E. BRANN, CPA
DEPUTY STATE CONTROLLER

October 26, 2007

Rebecca M. Wyke, Commissioner of Administrative & Financial Services
3rd Floor Cross Office Building
Station #78
Augusta, Maine 04333-0078

Commissioner Wyke:

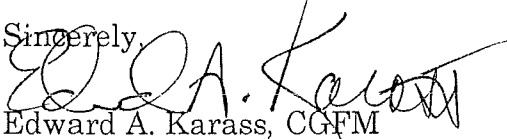
We have completed our audit of the relationship amongst several Cultural Agencies of State Government, the Maine Cultural Affairs Council, the Maine Community Cultural Alliance, a private non-profit corporation, and Verrill Dana, LLC. While the money involved to date is less than \$5,000 of State and Federal money, we find this relationship to be odd in its nature. There is no clear separation between the State, its employees, and the MCCA. Also, we find there to be too many vagaries surrounding the activity that has been engaged in by all involved including the role of the MCCA's contract with its vendor.

We have provided you with a narrative of the events and description of the relationship as we understand it. The participation by representatives of the State has been acknowledged through our interviews with the principals and also confirmed by our audit evidence.

We have provided the Directors of the four primary Cultural Agencies with our conclusion, findings, and recommendations regarding this complicated relationship. We have taken their comments into consideration in the final version of the report. It is fair to say that there is substantial disagreement between the Office of the State Controller and the Directors of the Library, Museum, Arts Commission, and Historic Preservation Commission regarding the findings and recommendations we put forth for their consideration and action.

I would be happy to discuss the result of this phase of a multi - phase internal control audit of the Cultural Agencies with you at your earliest convenience.

Sincerely,


Edward A. Karass, CGFM
State Controller

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October 26, 2007

Alden Wilson, Director
Gary Nichols, Director
Earle Shettleworth, Director
J.R. Phillips, Director
Donna McNeil, Deputy Director

Thank you for your thoughtful comments regarding the draft of the Audit Report. I met with my senior staff to review your comments with the goal of incorporating as many of your suggested changes as possible and to clarify those areas that you believed required clarification. Your suggestions have helped to make this a better product for all of us.

From here, the report is transmitted to Commissioner Wyke for her review as well as discussion with all concerned. I would encourage you to make an appointment with her to discuss any concerns that you may have regarding the audit.

I have read through your comments regarding the audit process. Unfortunately, an audit of this type and scope is outside the normal audit procedure and protocol. It is somewhat adversarial in nature with communication typically going in one direction. I have reviewed your comments regarding the meeting of September 12, 2007 with my staff. We have a different recollection of the events on this date.

I am also assuring you that the auditor did not have any finding and conclusions developed before the initial meeting with you. Sometimes, when information is not immediately volunteered, investigatory methods must be employed.

Once again, thank you for your thoughtful comments. They are a help to understand the dynamics as we continue with the Internal Control Audit of your agencies.

Sincerely,

Edward A. Karass, CGFM
State Controller

Internal Audit Review of the State of Maine's Relationship to the Maine Community Cultural Alliance and Verrill Dana, LLC

Background and Scope

In late June, 2007, several individuals came forward with allegations of possible wrongdoing and unethical behavior on the part of the state cultural agencies. We met with these individuals several times to make sure we had a clear understanding of the issues being presented. We then began examining objective evidence to determine if these allegations had any merit. Our initial work supported the basic facts of the allegations and also brought to light additional issues which require further inquiry. Therefore, we broadened the scope of our review to include a general internal control review of the cultural agencies. This report summarizes the findings related only to the allegations concerning the financial operations and financial relationships between the Cultural Agencies, the Maine Community Cultural Alliance, and Verrill Dana, LLC.

Maine Cultural Affairs Council

The Maine Cultural Affairs Council (CAC) consists of a chair of the Cultural Affairs Council (appointed by the Governor), the chairs and vice-chairs of the Maine Arts Commission, Maine Historical Preservation Commission, Maine Library Commission, Maine State Museum Commission, Maine State Archives Advisory Board, Maine Humanities Council, and Maine Historical Society. Non-voting members consist of the directors of the seven cultural agencies and the governor's liaison.

The Maine Community Cultural Alliance

The allegation concerned the implementation of a process to circumvent the prohibition of using state or federal funds to pay for lobbying activities by creating a corporation through which to process these payments. While the Articles of Incorporation filed with the Secretary of State on December 14, 2004 for the Maine Community Cultural Alliance (MCCA) and the terms of an unsigned engagement letter with Verrill Dana, LLC seem to indicate lobbying/advocacy activities were contracted for, the Office of the State Controller does not draw any conclusions regarding this issue. To have a fair perspective on the financial activities involved requires reviewing the full context of related activities over more than two year's time.

History and Context

The Maine Community Cultural Alliance was an active organization in the 1990's whose primary purpose was to promote the activities of the various cultural organizations that were represented on the board. With the enactment of the New Century Communities Program in 1999 (PL 1999, C. 401, PL2001, C401), the organization became dormant because this new program was really the result and culmination of the group's work.

During 2004, members of the Cultural Affairs Council began discussions with Verrill Dana, LLC. According to the terms of an unsigned engagement letter provided by Verrill Dana, LLC to the MCCA and members of the Cultural Affairs Council, Verrill Dana was to provide advice on legislative matters and strategy initiatives to promote the Cultural Agencies' agenda before the Governor and Legislature. The specific participants from the Cultural Affairs Council who were directly involved in this venture are vague regarding specific meeting dates and topics of discussion. We have been unable to locate any meeting minutes of the Cultural Affairs Council from this time period.

As a result of meetings amongst Verrill Dana, LLC, the Directors of the Cultural Agencies, other members of the CAC, and others representing community based cultural agencies, on December 14, 2004, Articles of Incorporation for the Maine Community Cultural Alliance as a 501(c)(4) organization were filed with the Maine Secretary of State to revive the MCCA. The audit evidence suggests that the decision to revive the MCCA was made with the full knowledge and participation of the directors of the several cultural agencies who were in place at this time.

Control of the organization's finances was vested in the treasurer of the MCCA. As we conducted our field work, we could not locate any documents related to an initial funding plan or budget for the organization. We have been unable to locate any official roster of board members or any meeting minutes for the Maine Community Cultural Alliance. However, Verrill Dana, LLC was working on behalf of the Alliance during the second half of 2004 and the first half of 2005 according to the engagement letter.

As late as March 2006, Verrill Dana, LLC and employees of the State of Maine (Cultural Agencies) were continuing to refine the mission of the MCCA and the relationships between Verrill Dana, LLC and the Cultural Agencies. As noted in a series of emails on March 24, 2006 that were passed amongst Verrill Dana, LLC, Treasurer of MCCA, and the Director of the Arts Commission:

1. Agency directors and Verrill and Dana representatives will continue to review legislation for advocacy purposes.
2. We agree that the Cultural Affairs Council office will serve as a central resource for monitoring and communications regarding legislative initiatives.
2. We agree that the Cultural Affairs Council office should serve as a collection site for and substantial generator of correspondence, legislative testimony, op ed drafts, and other written materials as .
3. We agree that Verrill and Dana will continue as consultants to the Community Cultural Alliance on matters of tactics and strategies relating to pending and proposed legislation and major fundraising initiatives.
4. We agree that the Cultural Affairs Council and its designee should remain active with the Executive Department's Creative Economy Initiative, including engaging with the redevelopment efforts relating to the Brunswick Naval Air Station.
5. We agree that the Cultural Affairs Council should encourage and advise the Community Cultural Alliance to seek grant support from national foundations that are interested in innovative methods to preserve and promote culture.

We note at this point in our narrative and understanding of the events surrounding the MCCA, the Cultural Agencies, and Verrill Dana, LLC, that prior to February 27, 2006, the Treasurer of MCCA was a private citizen; however, on February 27, 2006, the Treasurer of MCCA was hired by the Maine State Library (MSL), a state agency, as a Planning and Research Associate II while continuing his duties as treasurer and registered agent for the MCCA. The exchange of the aforementioned emails took place nearly one full month after this person accepted state employment.

The initial funding of the MCCA resulted in the Maine Arts Commission contributing \$3,000 (Federal Funds), the Maine State Museum contributing \$1,000 (General Fund) and other non-state organizations contributing a net total of \$14,944. Of the total funds available of \$18,944, \$14,500 was paid to Verrill Dana, LLC, and \$2,221.57 was used for a survey and other corporate expenses. On April 5, 2007, \$2,222.43 was returned the State of Maine and deposited to the Cultural Affairs Council's Other Special Revenue Account – New Century Program/Library instead of the accounts of origination. In light of the subsequent disbursements to Verrill Dana, LLC, we argue that the Arts Commission and the Maine State Museum contributed state funds to the MCCA with the knowledge that these funds would be directly used to pay for costs incurred by MCCA for Verrill Dana's services. The Arts Commission used federal funds for its contribution and the Maine State Museum used general fund money. According to Federal guidance in OMB A-87 (cost principles for State, Local, and Indian

Tribal Governments), the costs of membership in an organization substantially engaged in promotional activities are unallowable and the \$3,000 in federal funds used to pay dues to MCCA should be returned to the federal government. We question the disposition of the funds that were returned to the State of Maine and deposited to the New Century Program/Cultural Affairs Council's account. Please refer to Exhibits A & B for the flow of monies to the MCCA and its financial transactions.

Verrill Dana, LLC submitted its first invoice to the Maine Community Cultural Alliance for \$51,898.77 in July of 2005. The Maine Community Cultural Alliance and Cultural Affairs Council were unprepared for this significant invoice because of poor control, little monitoring of Verrill Dana, LLC's efforts, and lack of a signed engagement letter to limit the scope of their work. During the course of our audit, we could not locate any specific tangible work product, such as a report or written strategy plan, created by Verrill Dana, LLC as a result of this engagement except for the Articles of Incorporation and the by-laws for the MCCA.

From the initial round of funding for the Maine Community Cultural Alliance, the council was able to pay Verrill Dana, LLC \$12,000 at the end of 2005. In November, 2006, the Maine Humanities Council and Maine Historical Society paid an additional \$3,000 each to the MCCA, but this money was returned three months later. The Maine Humanities Council subsequently sent the \$3,000 directly to Verrill Dana, LLC, along with an additional \$5,000 in March, 2007.

There was no further activity conducted by the Maine Community Cultural Alliance other than a final payment of \$2,500 to Verrill Dana, LLC in January, 2007. Of the almost \$132,000 in gross billing for this engagement, Verrill Dana, LLC discounted, wrote off or classified as pro bono a total of \$103,000 at the conclusion of the engagement.

We assert that it is likely there was a general acknowledgement and understanding that state agencies are not allowed to fund and participate in private non profit corporations to act on their behalf in the manner described here in. Nevertheless, the council decided that the best way to achieve their goals was through this independent non-profit corporation. Reference to the MCCA and efforts to revive it are clearly stated in the minutes of the Maine Library Commission in July, 2006. Additionally, in the February 8, 2007, minutes of the Arts Commission, Rebecca Conrad, Deputy Chair, "reported the Maine Community Cultural Alliance (MCCA) is a private organization that... had been working on obtaining a 501 (C) 3 status. The mission of the organization would be to provide advocacy for the cultural agencies. The Cultural Affairs Council has put this idea on hold for the time being."

In the minutes of the March 9, 2007, Arts Commission meeting, the Vice Chair reported that, "Creative Maine the former Maine Community Cultural Alliance is a working group that was developed to advocate for the cultural agencies. On March 26, the Cultural Affairs Council will discuss the status of the Creative Maine."

Findings

▪ Internal Control over Financial Administration

Our review of the events and circumstances surrounding the intricate relationship amongst all of the parties involved in this series of events has revealed material weaknesses in the internal control structure of the administration of the Cultural Agencies' finances.

We believe that the Agencies do not have a financial administrative structure of sufficient sophistication and independence to adequately advise or challenge as the case may be, the financial decisions that are made on a daily basis to ensure compliance with state and federal fiscal policies, procedures, and law.

▪ **Misuse of State Funds**

While in this series of events only a few thousand dollars of state money is directly connected to the funding of the activities of the MCCA, we believe the funds have been used in an inappropriate manner. Our review of the budgets enacted by the Legislature for these agencies did not reveal an identifiable request for an appropriation or allocation of funds to be used for funding of a private non profit corporation to be set up to pay the costs of the retention of advocacy or other strategic services on behalf of the Cultural Agencies. We do note that the payment of the state and federal funds to the MCCA was recorded in the State's official accounting records as dues paid to the MCCA. We could not find an adopted schedule for dues assessment by the Board of the MCCA as there was no Board in-place.

A review of Maine Law reveals that the Legislature did anticipate that agencies would, in fact, engage in advocacy to promote their programs, agendas, and budget requests in various settings in the legislative arena. PL 1993, c. 691 clearly stated the requirements for state employees:

Within 5 days of the convening of a regular legislative session, a state employee or an independent agency employee must register at the office of the commission as described in section 316-A if:

- 1. Legislative designee. The employee is designated by the head of a department or agency to serve as the primary legislative designee for that department or agency; and**
- 2. Lobbying requirements. The job description of the employee contains lobbying requirements.**

An employee registering under this section is exempt from all other requirements under the law regarding lobbyists.

▪ **Non Compliance with Title 27, §557**

With direct respect to those agencies comprising those known as the cultural agencies and the programs of these organizations, the Legislature enacted PL 1989, c. 700, Part B, § 42 creating the Cultural Affairs Council which would act as a coordinator for several cultural agencies to, among its duties, report to the Governor and legislature on an annual basis as required by Title 27, § 557 which states:

§557. Annual report

The Maine State Cultural Affairs Council shall annually report to the Governor and the Legislature. The directors shall provide the necessary information and assist the council in the preparation of this report. This report shall include the following:

- 1. Receipts and expenditures. The receipts and expenditures on the accounts of the cultural agencies;**
- 2. Acquisitions. The number of acquisitions by the cultural agencies, specifying those obtained by purchase, donation or exchange;**
- 3. Program accomplishments. The accomplishments of the programs within the cultural agencies;**
- 4. Program needs. The program needs of the cultural agencies; and**
- 5. Improvements. Suggestions for improvement of the individual programs within the cultural agencies and for the improvement of delivery of cultural services in the State.**

We could not locate any reports by the Council that would satisfy the requirement of the law.

▪ **Inadequate Control over Compliance**

- The Directors on behalf of the Cultural Affairs Council should have consulted with the office of the Attorney General to determine the appropriateness of participating in the establishment and funding of an outside corporation that would receive and expend money for legislative advocacy as described in its charter.
- The Directors should have sought a budgetary request from the Legislature with the assistance from the Commissioner of Administrative and Financial Services to address their financial obligation to MCCA and to Verrill Dana, LLC as the final recipient of the flow through of money from the MCCA and the State.
- The Cultural Affairs Council and the agencies represented by the Council should refrain from any similar relationships in the future where there is no clear separation between the State of Maine, its employees or agents, and the external body. The scope and authority of the council to enter into any binding agreements on behalf of the State should comply with Maine Law and procurement regulations to ensure that all agreements and the manner in which they are executed meet standards as set forth in Financial Order 10, FY88/89 dated April 1, 1989, and all legal requirements.

Conclusion

There should be no doubt, in our opinion, that the effort to revive the Maine Community Cultural Alliance was poorly thought out and managed in almost every aspect.

Recommendations

- Whenever a state official or legislatively authorized body commits or expends funds for any purpose, an agreed upon service or product is identified and received consistent with current state purchasing requirements.
- The funds deposited to the New Century Library Program from the refund of "dues" from the MCCA be returned to the accounts of origination and that a legislative appropriation be sought to restore the federal funds used for the purposes of funding MCCA activities in violation of Federal Circular OMB A - 87.
- The financial administration of the Cultural Agencies with the exception of the Archives be transferred to an established service center under supervision of the Commissioner of Administrative and Financial Services to ensure adequate financial controls are put into place and complied with by the Cultural Agencies as well as the financial stewards of the service center.
- The Directors of the Cultural Agencies review Executive Order #10 FY88/89 dated April 1, 1989. The Directors will review the Executive Order with the employees of their respective agencies, commission members, and the Cultural Affairs Commission members to ensure that there is an understanding and appreciation of the standards that all employees and representatives of Maine State Government must adhere to in the conduct of their business.
- The Directors of the Cultural Agencies consult with their assigned attorney in the Office of the Attorney General and with their liaison in Office of the State Controller whenever they are unsure of the legality or the appropriateness of any planned expenditure in advance to ensure that the rules, regulations, and laws are not violated.

Exhibit A

Maine Community Cultural Alliance Financial Transactions

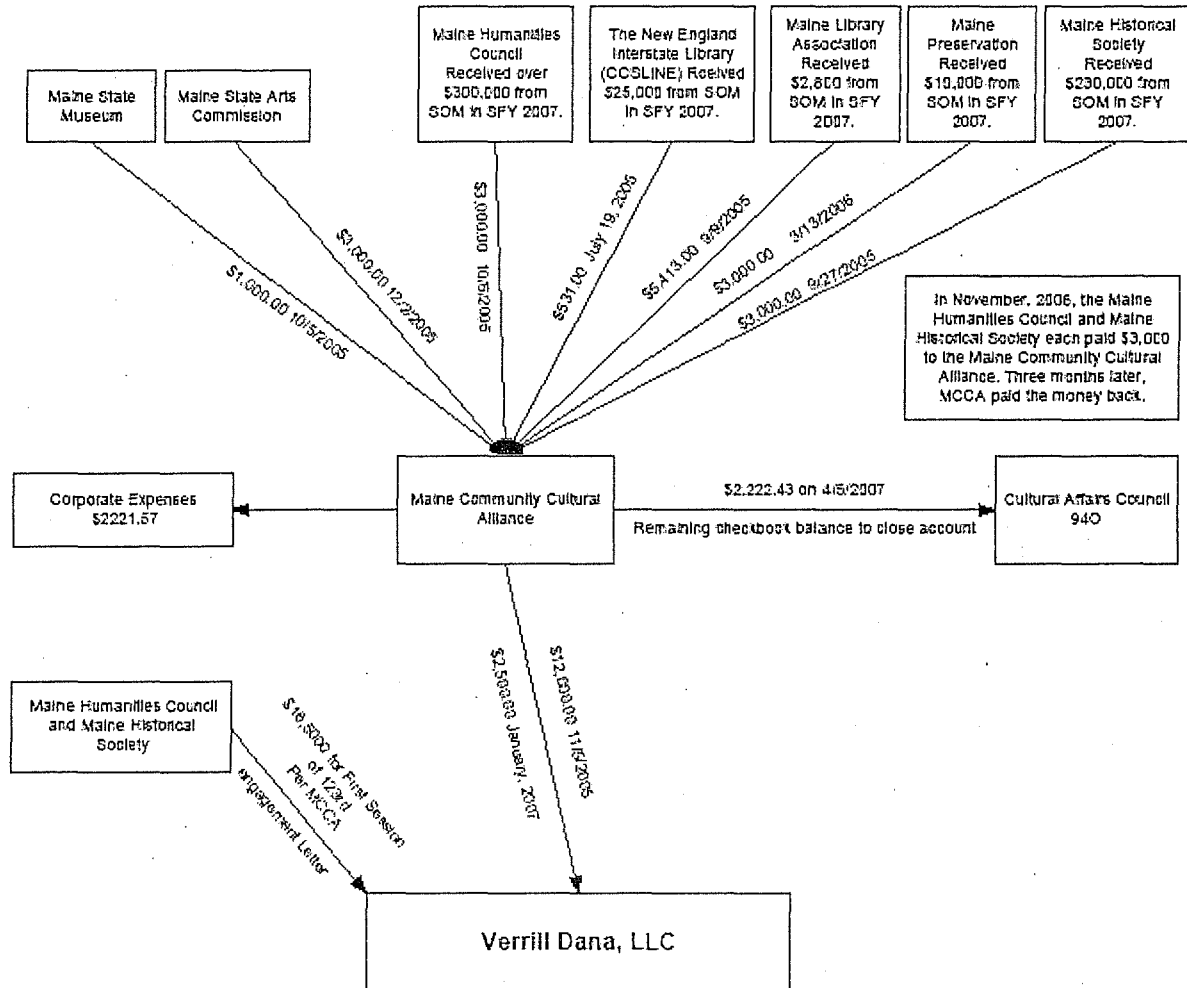


EXHIBIT B

Maine Community Cultural Alliance Summary of Cash Transactions

Deposits

7/19/2005 The New England Interstate Library	\$	531.00
9/9/2005 Maine Library Association	\$	5,413.00
9/27/2005 Maine Historical Society	\$	3,000.00
10/6/2005 Maine Humanities Council	\$	3,000.00
10/6/2005 Maine State Museum	\$	1,000.00
1/6/2006 Maine Arts Commission	\$	3,000.00
3/13/2006 Maine Preservation	\$	3,000.00
11/9/2006 Maine Humanities Council	\$	3,000.00
11/20/2006 Maine Historical Society	\$	3,000.00

Total Deposits \$ 24,944.00

Expenses

7/19/2005 Corporate Expenses	\$	(31.00)
1/31/2006 Corporate Expenses	\$	(100.00)
8/21/2006 David Cheever	\$	(450.00)
8/21/2006 Moody & Co.	\$	(22.57)
8/28/2006 USPS	\$	(78.00)
8/30/2006 USPS	\$	(39.00)
11/30/2006 Corporate Expenses	\$	(100.00)
12/21/2006 Corporate Expenses	\$	(100.00)
1/24/2007 Corporate Expenses	\$	(101.00)
3/9/2007 David Cheever - Expenses	\$	(1,000.00)
3/28/2007 David Cheever - Expenses	\$	(200.00)
Subtotal	\$	(2,221.57)

11/6/2005 Paid to Verrill Dana	\$	(12,000.00)
1/26/2007 Paid to Verrill Dana	\$	(2,500.00)
3/18/2007 Maine Historical Society	\$	(3,000.00)
3/18/2007 Maine Humanities Council	\$	(3,000.00)
3/28/2007 Returned to the Arts Commission	\$	(2,222.43)
Subtotal	\$	(22,722.43)

Total Expenses \$ (24,944.00)

Bank Statement Summary

Date	Check #	Source	Amount	Bank Balance
7/19/2005	Deposit	COSLINE	\$ 531.00	\$ 531.00
7/19/2005	Cash	Corporate Expenses	\$ (31.00)	\$ 500.00
9/9/2005	Deposit	Maine Library Association	\$ 5,413.00	\$ 5,913.00
9/27/2005	Deposit	Maine Historical Society	\$ 3,000.00	\$ 8,913.00
10/6/2005	Deposit	Maine Humanities Council	\$ 3,000.00	\$ 11,913.00
10/6/2005	Deposit	Maine State Museum	\$ 1,000.00	\$ 12,913.00
11/6/2005	576	Verrill Dana	\$ (12,000.00)	\$ 913.00
1/6/2006	Deposit	Maine Arts Commission	\$ 3,000.00	\$ 3,913.00
1/31/2006	Cash	Corporate Expenses	\$ (100.00)	\$ 3,813.00
3/13/2006	Deposit	Maine Preservation	\$ 3,000.00	\$ 6,813.00
8/21/2006	551	Corporate Expenses	\$ (450.00)	\$ 6,363.00
8/21/2006	552	Corporate Expenses	\$ (22.57)	\$ 6,340.43
8/28/2006	553	Corporate Expenses	\$ (78.00)	\$ 6,262.43
8/30/2006	554	Corporate Expenses	\$ (39.00)	\$ 6,223.43
11/9/2006	Deposit	Maine Humanities Council	\$ 3,000.00	\$ 9,223.43
11/20/2006	Deposit	Maine Historical Society	\$ 3,000.00	\$ 12,223.43
11/30/2006	Cash	Corporate Expenses	\$ (100.00)	\$ 12,123.43
12/21/2006	556	Corporate Expenses	\$ (100.00)	\$ 12,023.43
1/24/2007	557	Corporate Expenses	\$ (101.00)	\$ 11,922.43
1/26/2007	559	Verrill Dana	\$ (2,500.00)	\$ 9,422.43
3/9/2007	560	Corporate Expenses	\$ (1,000.00)	\$ 8,422.43
3/18/2007	561	Maine Humanities Council	\$ (3,000.00)	\$ 5,422.43
3/18/2007	562	Maine Historical Society	\$ (3,000.00)	\$ 2,422.43
3/28/2007	563	Returned to Cultural Affairs Council	\$ (2,222.43)	\$ 200.00
3/28/2007	Cash	Corporate Expenses	\$ (200.00)	\$ 0.00

OF

MAINE COMMUNITY CULTURAL ALLIANCE

ARTICLE I

DEFINITIONS

When used in these Bylaws, the terms defined below shall have the meanings specified:

"Articles" shall mean the Articles of Incorporation of the Corporation, including any and all amendments thereto, as then in effect.

"Board" shall mean the Board of Directors of the Corporation.

"Code" shall mean the Internal Revenue Code of 1986, as amended, and the regulations thereunder, as from time to time in effect.

"Corporation" shall mean Maine Community Cultural Alliance, a Maine nonprofit corporation.

"Corporation Act" or the "Act" shall mean the Maine Nonprofit Corporation Act, of Title 13-B of the Maine Revised Statutes, as then in effect.

"State" shall mean the State of Maine.

ARTICLE II

9/16/2005

CORPORATE OFFICES

SECTION 2.1 Principal Office. The principal office of the Corporation shall be located in Augusta, Maine, or such other place as the Board may designate from time to time.

SECTION 2.2 Registered Office. The registered office of the Corporation shall be at One Portland Square, P.O. Box 586, Portland, Maine, or at such other address as the Registered Agent of the Corporation shall maintain.

SECTION 2.3 Other Offices. The Corporation may have offices at such other places either within or without the State as the Board may determine or as the business may require.

ARTICLE III

PURPOSES

SECTION 3.1 Purposes. The Corporation is organized as a public benefit corporation for all purposes permitted under Title 13-B M.R.S.A. §101 *et seq.*, as amended, and for the following specific purposes: for the promotion of social welfare within the meaning of Section 501(c)(4) of the Code, including, but not limited to:

- (a) working with the Maine State legislature to highlight the importance of cultural resources in Maine, such as museums, libraries, historic preservation, and the arts and lobbying for policies and appropriations beneficial to such constituencies; and
- (b) engaging in any and all lawful activities incidental to and in pursuit of the foregoing purposes, except as restricted herein.

SECTION 3.2 Powers. The Corporation shall have all powers authorized to nonprofit corporations by the Corporation Act, provided that all the assets and income of the Corporation shall be used exclusively for the promotion of social welfare, and no part thereof shall inure to the benefit of any private individual; provided, however, that nothing contained herein shall be construed to prevent the payment by the Corporation of reasonable compensation and expenses to directors, officers, employees, or independent contractors of the Corporation.

SECTION 3.3 Distribution on Dissolution. If the Corporation is dissolved or its legal existence terminated, either voluntarily or involuntarily, or upon final liquidation of the Corporation, none of its assets shall inure to the benefit of any private individual, and all of its assets remaining after payment of all of its liabilities shall be distributed to one or more organizations which the Board then determines is qualified both as an exempt organization under Section 501(c)(4) of the Code, and as an organization engaged in activities substantially similar to those of this Corporation, or which is an otherwise eligible entity.

SECTION 3.4 Tax-Exempt Status. It is intended that the Corporation shall have and continue to have the status of an organization which is exempt from federal income tax under Section 501(a) of the Code, as an organization described in Section 501(c)(4) of the Code. The Articles and these Bylaws shall be construed accordingly, and all powers and activities shall be limited accordingly.

ARTICLE IV

MEMBERSHIP

SECTION 4.1 Members; Qualifications. There shall be two classes of Members: Organizational and Individual. To become a Member of the Corporation, an organization or an individual must have an interest in furthering the purposes of the Corporation, and make timely payment of annual Organizational and Individual membership dues, as established from time to time by the Board.

SECTION 4.2 Powers. Members shall have the right to attend an annual meeting at which they will receive a report from the Board or its representatives on the activities of the Corporation during the previous year, including any accomplishments the Corporation has achieved. Members shall have no voting rights.

SECTION 4.3 Annual Meeting; Notice And Waiver. The annual meeting of Members, shall be held each year in the month and at a time and place as may be fixed by the Board. Written notice of each annual meeting of Members, stating the place, day and hour of the meeting, shall be mailed or communicated electronically to each Member of the Association at least ten (10) but not more than sixty (60) days prior to such meeting at the Member's address as it appears on the organizational list of Members. A written waiver of notice signed by the Member or Members entitled to such notice, whether before or after the time stated therein, shall constitute a waiver of the Member's objection to the lack of or defective notice. Attendance at a meeting shall also constitute a waiver as to the lack of or defective notice, unless the Member at the beginning of the meeting objects to the holding of the meeting or transaction of business.

ARTICLE V

BOARD OF DIRECTORS

SECTION 5.1 Powers and Duties. The affairs and property of the Corporation shall be managed and controlled by a Board of Directors established pursuant to this Article V. All corporate powers are hereby vested in and shall be exercised by the Board. The Board shall have full power to adopt rules and regulations governing all actions which it takes to carry out the purposes of the Corporation, except as otherwise provided by the Corporation Act. The Board may, except as otherwise provided by the Corporation Act, delegate to committees or to officers of the Corporation, such powers as it may see fit.

SECTION 5.2 Qualifications. Directors must have attained the age of twenty-one years and must be committed to the improvement and support of Maine cultural resources.

SECTION 5.3 Number, Election, Term of Office and Removal. The number of directors on the initial Board shall be seven (7), each representing one of the disciplines represented by the member agencies of the Maine State Cultural Affairs Council, as established by 5 M.R.S.A. § 12004-G, subsection 7-A. Thereafter, the number of directors may be varied by the Board at its annual meeting (or more often, if desired), provided that the number shall be fixed at no fewer than three (3) and no more than twenty (20). Directors shall be elected for staggered three (3)-year terms. Directors shall be divided into three (3) classes, with each class to be designated by the year in which its members' terms expire. Except as hereinafter provided, approximately one-third of the Board shall be elected each year at the annual meeting. Directors shall be elected by the affirmative vote of a majority of the directors present at the meeting, provided that a quorum is then present. Each director shall hold office until the expiration of the term for which he or she is elected and until his or her successor has been elected and qualified, or until his or her earlier resignation, removal from office, death, or incapacity. Unless otherwise provided by the Board, no director shall serve for more two consecutive three-year terms. Any director may be removed, with or without cause, by the affirmative vote of a majority of the directors then in office.

SECTION 5.4 Vacancies. A vacancy arising at any time and from any cause shall be filled for the unexpired term through majority vote of the directors then in office. In any case, each vacancy shall be filled no later than 90 days after its occurrence.

SECTION 5.5 Resignation. Any director may resign at any time by giving written notice of such resignation to the President or Secretary of the Corporation. Unless otherwise specified therein, a resignation shall take effect upon receipt of such notice and the acceptance of such resignation shall not be necessary to make it effective.

SECTION 5.6 Meetings; Notice. An annual meeting of the Board shall be held at a time and place fixed by the Board. Notice of the time and place of such annual meeting shall be given in such form as the Board may determine. Regular meetings of the Board shall be held at least three times per year at such time and place as shall be determined by the Board. Special meetings of the Board may be called at any time by the President, or by any other individual so authorized by the Board, or by any two (2) directors then in office. Notice of the place, date, and time of each regular or special meeting (i) shall be mailed to each director, addressed to his or her residence or usual place of business, at least three business days before the meeting or (ii) shall have been sent to him or her at such place by e-mail, telegram or cable, or received by him or her in person by telephone or fax, at least twenty-four hours before the meeting. Except as otherwise expressly required by the Act, the Articles, or these Bylaws, notices of meetings need not describe the purposes of, or business to be transacted at, the meeting. Notice of any meeting of the Board need not be given to any director who is present at such meeting or who signs a written waiver of notice, either before or after the meeting. Notice of adjournment of any meeting need not be given if the time and place to which it is adjourned are fixed and announced at such meeting. Notwithstanding any provision of these Bylaws, defects in the calling or notice of a meeting of directors shall be deemed waived to the extent provided by the Act.

SECTION 5.7 Quorum. At all meetings of the Board, a majority of the directors then in office shall constitute a quorum for the transaction of business. The action of a majority of the directors present at any meeting at which a quorum is present shall be the act of the Board, except as otherwise provided by these Bylaws.

SECTION 5.8 Corporation. At all meetings of the Board, the President of the Corporation, or, in the absence of the President, a temporary chair chosen by the directors from among their number, shall preside. The Secretary of the Corporation shall act as secretary at all meetings of the Board. In the

absence of the Secretary, the presiding officer shall appoint any person to act as secretary of the meeting.

SECTION 5.9 Compensation. Directors shall serve without fixed salary for their services as such, but a reasonable fee or the expenses (if any) for attendance, or both, may be allowed, on resolution of the Board, for attendance at each annual, special or regular meeting of the Board. The Board shall have the power to compensate any director who becomes an employee of the Corporation.

SECTION 5.10 Telephonic Meetings. Members of the Board or any committee thereof may participate in a meeting of the Board or such committee by means of a conference telephone, video conferencing or similar communications equipment by which all persons participating in the meeting can hear each other at all times. Participation in a meeting pursuant to this section shall constitute presence in person at such meeting.

SECTION 5.11 Consent of Directors. Any action required or permitted to be taken at a meeting of the Board or of any committee thereof may be taken without a meeting if written consents, setting forth the action taken, are signed (at any time before or after the intended effective date of such action) by all members of the Board or committee, as the case may be. Such consents shall be filed with the Secretary as part of the corporate records.

ARTICLE VI

COMMITTEES OF THE BOARD

SECTION 6.1 Executive Committee. The Board by act of at least a majority of the entire Board may select an Executive Committee composed of at least two directors to exercise some or all of the Board's powers between Board meetings. The powers and duties of the Executive Committee shall be as specified in the resolution authorizing its creation. The Board shall designate one person to serve as chair of the Committee. Notwithstanding the foregoing, the Executive Committee shall have no authority as to the following matters:

- (a) The filling of vacancies on the Board or in any committee.
- (b) The fixing of compensation of the directors for service on the Board or any committee.
- (c) The amendment or repeal of the Bylaws or the adoption of new Bylaws.
- (d) The amendment or repeal of any resolution of the Board, which by its terms shall not be so amendable or repealable.

The members of the Executive Committee shall serve at the pleasure of the Board. The Executive Committee shall fix its own rules of procedure as approved by the Board and shall meet as provided by such rules or by resolution of the Board. The Executive Committee may appoint committees of the

Executive Committee, with such powers as the Executive Committee may determine.

SECTION 6.2 Other Committees. The Board, with approval of a majority of the entire Board, may designate from among its members such other committees, including an Audit Committee, as it may deem advisable. The Board may discontinue any such committee at its pleasure. Each such committee shall have such powers and perform such duties, not inconsistent with law, as may be assigned to it by the Board.

ARTICLE VII

OFFICERS

SECTION 7.1 Officers. The officers of the Corporation shall be a President, Secretary, Treasurer, and such other officers with powers and duties not inconsistent with these Bylaws as the Board may from time to time appoint or elect. In addition, the President may from time to time appoint such Assistant Treasurers and Assistant Secretaries as he or she shall deem appropriate. Any two or more offices may be held by the same person. No instrument to be signed by more than one officer may be signed by one person in more than one capacity.

SECTION 7.2 Election; Term of Office; Removal. Officers shall be elected at the annual meeting of the Board for a term fixed by the Board, and shall serve until their successors are chosen and have qualified, or until their earlier resignation or removal from office. All officers serve at the pleasure of the Board and may be removed at any time by the Board, with or without cause. Assistant Treasurers and Assistant Secretaries appointed by the President may also be removed by the President at any time, with or without cause. Removal from office, however effected, shall not prejudice the contract rights, if any, of the officer removed, nor shall election or appointment of an officer of itself create contract rights.

SECTION 7.3 Vacancies. A vacancy in any office, however occurring, shall be filled in the manner prescribed by these Bylaws for regular election or appointment to such office. An officer elected to fill such a vacancy shall be elected for the unexpired term of his or her predecessor.

SECTION 7.4 Resignations. Any officer may resign by giving written notice to the President or Secretary. Unless otherwise specified therein, a resignation shall take effect upon receipt of such notice, and the acceptance of such resignation shall not be necessary to make it effective.

SECTION 7.5 Powers and Duties. Except as hereinafter provided and subject to the control of the Board, each officer shall have such powers and duties as are customarily incident to his or her office or as the Board may otherwise prescribe.

- (a) President. The President shall supervise and direct all officers and employees of the Corporation, and shall see that all orders and resolutions of the Board are carried into effect. The President shall have authority to appoint and remove employees and agents and to prescribe their powers and duties and may authorize any other officer or officers to do so and shall have such other duties as may be determined by the Board. The President shall have authority to institute or defend legal proceedings whenever the

directors are deadlocked.

- (b) Secretary. The Secretary (or, in the absence of the Secretary, another person designated by the President) shall attend meetings of the Board and record its proceedings. He or she may give, or cause to be given, notice of all meetings of directors of the Corporation. The Secretary shall keep records of all meetings of the Board and committees thereof. The Secretary may certify all votes, resolutions, and actions of the Board and committees of the Board, and may attest all documents executed on behalf of the Corporation.
- (c) Treasurer. The Treasurer shall have charge of, and be responsible for, all funds and securities of the Corporation, shall maintain full and accurate accounts of the Corporation's disbursements and receipts, shall report to the Board from time to time on the financial condition of the Corporation, and shall otherwise exercise the powers and perform the duties incident to the office of Treasurer. The Treasurer may certify or attest documents executed on behalf of the Corporation. The Treasurer may delegate the duties described herein to staff, subject, however, to any Board restriction on check signing authority.
- (d) Assistant Officers. Assistant Treasurers and Assistant Secretaries shall perform such duties as from time to time may be assigned to them by the Board or by (respectively) the Treasurer or Secretary. At the request of the Treasurer or Secretary, or in case of his or her absence or inability to act, any Assistant Treasurer or Assistant Secretary (respectively) may act in his or her place.

SECTION 7.6 Registered Agent. The Corporation shall, in accordance with Maine law, designate a Registered Agent, who shall not be deemed an officer of the Corporation. The position of Registered Agent shall be ministerial in nature, and the Registered Agent, in his, her or its capacity as such, shall have no authority to engage in any policy-making function on behalf of the Corporation, or to enter into contracts or incur debts on behalf of the Corporation. The Registered Agent may, but need not, hold another position as an officer of the Corporation.

SECTION 7.7 Compensation. The compensation, if any, of all officers shall be fixed by the Board and shall be reasonable in amount, and the fact that any officer also is a director of the Corporation shall not preclude his or her receiving compensation for services rendered as an officer.

ARTICLE VIII

CONTRACTS, BANK ACCOUNTS, ETC.

SECTION 8.1 Execution of Documents. Except as limited by law, the Articles, or these Bylaws, and unless otherwise expressly provided by any resolution of the Board, the President or his or her designee shall have authority to execute and deliver, in the name and on behalf of the Corporation, any contract, bill, note, check, deed, mortgage, bill of sale, or other instrument.

SECTION 8.2 Bank Accounts. Unless otherwise expressly provided by any resolution of the Board, the President, the Treasurer, or their designees, acting singly or jointly, may open, close, and maintain deposit, checking, money market, and similar accounts with banks, trust companies, and other depositories in the name of the Corporation and may purchase and sell certificates of deposit and similar instruments on behalf of the Corporation. The Board may make such special rules and regulations with respect to such activities as it deems expedient.

SECTION 8.3 Authority to Vote Shares. Unless otherwise provided by resolution of the Board, the President, the Treasurer, and the Secretary (in that order) shall have authority to vote (either in person or by proxy) any shares of other corporations standing in the name of the Corporation.

ARTICLE IX

INDEMNIFICATION

SECTION 9.1 Mandatory Indemnification of Directors and Officers. Except to the extent expressly prohibited by law or by the Articles or these Bylaws, the Corporation shall in all cases indemnify any existing or former director or officer of the Corporation who was or is a party or is threatened to be made a party to any threatened, pending, or completed action, suit, or other proceeding, whether civil, criminal, administrative, or investigative, by reason of the fact that he or she is or was a director, officer, employee, or agent of the Corporation or is or was serving at the request of the Board as a director, officer, trustee, partner, manager, fiduciary, employee, or agent of another corporation, partnership, limited liability company, joint venture, trust, pension or other employee benefit plan, or other enterprise, or by reason of his or her conduct in any such capacity, against expenses (including, without limitation, costs of investigation and attorneys' fees, judgments, fines, penalties, and amounts paid in settlement) actually and reasonably incurred by him or her in connection with such action, suit, or proceeding; provided, however, that indemnification shall not be mandatory in respect of (i) any action or claim by such person against the Corporation, or against one or more directors or officers of the Corporation in their capacities as such, or (ii) any action or claim by or in the right of the Corporation against such person if such action or claim was approved, prior to the filing thereof, by the affirmative vote of at least two-thirds of the directors of the Corporation then in office.

SECTION 9.2 Permissive Indemnification. Except to the extent that indemnification is mandatory under Section 9.1 above, the Corporation may, but shall not be required to, indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending, or completed action, suit, or other proceeding, whether civil, criminal, administrative, or investigative, by reason of the fact that he or she is or was a director, officer, employee, or agent of the Corporation or is or was serving at the request of the Corporation as a director, officer, trustee, employee, partner, manager, fiduciary, or agent of another corporation, partnership, limited liability company, joint venture, trust, pension or other employee benefit plan, or other enterprise, or by reason of his or her conduct in any such capacity, against expenses (including, without limitation, costs of investigation and attorneys' fees, judgments, fines, penalties, and amounts paid in settlement) actually and reasonably incurred by him or her in connection with such action, suit, or proceeding. Such indemnification shall be subject to any restrictions imposed by applicable law or by the Board in its discretion.

SECTION 9.3 Indemnification Not Permitted. The Corporation shall not indemnify a person under this

Article if he or she breached his or her duty to act in good faith and in a manner believed to be in or not opposed to the best interests of the Corporation; or, in the case of any criminal proceedings, if the person had reasonable cause to believe his or her conduct was unlawful. Likewise, the Corporation shall not indemnify a person under this Article in connection with a proceeding by or in the right of the Corporation in which that person was or is adjudged liable to the Corporation, or in connection with any other proceeding charging improper personal benefit to that person, whether or not involving action in that person's official capacity, in which that person was adjudged liable on the basis that personal benefit was improperly received by that person.

SECTION 9.4 Advance Payment of Expenses.

(a) With respect to any claim for which indemnification is mandatory under Section 9.1 or permissible under Section 9.2 above, all expenses reasonably incurred by any existing or former director or officer in connection with such claim may, in the discretion of the Board, be paid by the Corporation in advance of the final disposition of the action, suit, or proceeding in which such claim is asserted or threatened.

(b) Notwithstanding paragraph (a) of this Section, no advance payment of expenses shall be made hereunder unless the Corporation shall be in receipt of:

- (i) A written undertaking by or on behalf of the indemnified person to repay that amount if such person is finally adjudicated not to be entitled to indemnification by the Corporation; and
- (ii) A written affirmation by the indemnified person that he or she (a) acted honestly and in the reasonable belief that his or her action was in or not opposed to the best interests of the Corporation or its shareholders (or, in the case of a person serving as a fiduciary of an employee benefit plan or trust, in or not opposed to the best interests of that plan or trust or its participants or beneficiaries) and (b) with respect to any criminal action or proceeding, that he or she did not have reasonable cause to believe that his or her conduct was unlawful.

The undertaking required by clause (i) of this paragraph (b) shall be an unlimited general obligation of the person seeking the advance, but (except to the extent otherwise provided by the Board pursuant to paragraph (a) of this Section) shall not be secured and shall be accepted without reference to financial ability to make the repayment.

SECTION 9.5 Nonexclusive Remedy: Benefit. The rights provided by this Article shall not be deemed exclusive of any other right of indemnification or payment provided by contract, the Articles, vote of directors, or otherwise. Any right of indemnity or payment arising under this Article shall continue as to a person who has ceased to hold the office or position in which such right arose; shall inure to the benefit of his or her heirs, executors, and administrators; and shall survive any subsequent amendment of this Article.

SECTION 9.6 Insurance. The Corporation may purchase and maintain insurance on behalf of itself and any person who is or was a director, officer, employee, or agent of the Corporation, or is or was serving at the request of the Corporation as a director, officer, trustee, partner, manager, fiduciary, employee, or

agent of another corporation, partnership, limited liability company, joint venture, trust, pension or other employee benefit plan, or other enterprise, against any liability asserted against such person and incurred by him or her in any such capacity, or arising out of his or her status as such, whether or not the Corporation would have the power to indemnify such person against such liability under the Corporation Act.

ARTICLE X

CONFLICT OR DUALITY OF INTEREST

SECTION 10.1 Disclosure. Each director shall disclose to the Board any financial or other relationship that might reasonably be construed to be inconsistent with the discharge of such director's duties to the Corporation, including without limitation his or her status as an officer, director, trustee, member, owner (either as sole proprietor or partner), shareholder, employee, or agent of any entity or organization with which the Corporation has entered into, or might be expected to enter into, a relationship or transaction in which that director might have a conflicting interest. Directors shall make such disclosures at least annually, at such times and in such form as the Board shall require.

SECTION 10.2 Effect of Conflict. A director may be interested, directly or indirectly, in any contract, transaction, or act relating to or incidental to the operations of the Corporation, and may freely make contracts, enter into transactions, or otherwise act for or on behalf of the Corporation in such matters, provided that (i) the direct or indirect interest of the director in the proposed contract, transaction, or act shall have been disclosed to and approved by the Board; and (ii) the director shall refrain from participating in discussions regarding, or voting on, any contract, transaction or act in which she or he has an interest. An interested director may be counted in determining the presence of a quorum at a meeting at which the Board authorizes, approves, or ratifies a transaction in accordance with the requirements of this Article.

ARTICLE XI

GENERAL PROVISIONS

SECTION 11.1 Fiscal Year. The fiscal year of the Corporation shall end on December 31 of each year, except as otherwise fixed by resolution of the Board.

SECTION 11.2 Corporate Seal. The Corporation may have a seal in such form as the Board or the Registered Agent may approve. Whenever it is inconvenient to use the corporate seal, a facsimile thereof may be used. The Registered Agent and any officer of the Corporation shall have authority to affix the corporate seal, and it may be attested by his or her signature.

SECTION 11.3 Signatures; Electronic Transmission. Facsimile, conformed, or electronic signatures of any officer of the Corporation may be used whenever authorized by the Board or the President. The Corporation may rely upon a facsimile, conformed, or electronic signature of any person if delivered by or on behalf of such person in a manner evidencing an intention to permit such reliance. Documents delivered by e-mail, fax, or other means of electronic transmission shall be deemed, upon receipt by the

Corporation in legible form, to constitute a writing even if not reproduced in paper form. Any such electronic transmission from a director consenting to an action shall be deemed to be signed and dated if such transmission sets forth, or is delivered with, information from which the Corporation in good faith determines that the transmission was sent by such person or by an agent authorized to deliver such consent for such person.

SECTION 11.4 Amendment of Bylaws. Except as the Articles otherwise provide, these Bylaws may be amended or repealed, and new Bylaws may be adopted, by the affirmative vote of a majority of the directors then in office. For any meeting at which Bylaws are to be adopted, amended, or repealed, specific notice of such proposed action shall be given, either setting out the text of the proposed new or amended Bylaw or Bylaw to be repealed, or summarizing the changes to be effected by such adoption, amendment, or repeal.

SECTION 11.5 Interpretation. Headings and captions used herein are inserted for convenience only and shall not be used to construe the scope or content of any provision. In the case of any conflict between the provisions of the Articles and these Bylaws, the Articles shall control. In the case of any ambiguity or other question concerning interpretation of these Bylaws, the good faith interpretation of the Board, acting by the affirmative vote of a majority of the directors then in office, shall be binding on the Corporation for all purposes.

DOMESTIC
NONPROFIT CORPORATION

STATE OF MAINE

ARTICLES OF INCORPORATION

Filing Fee \$40.00

File No. 20050340ND Pages 5

Fee Paid \$ 40

DCN 2043571300003 ARTI

---FILED---

12/14/2004

Julie L. Flynn
Deputy Secretary of State

A True Copy When Attested By Signature

Julie L. Flynn
Deputy Secretary of State

Pursuant to 13-B MRSA §403, the undersigned incorporator(s) execute(s) and deliver(s) the following Articles of Incorporation:

FIRST: The name of the corporation is Maine Community Cultural Alliance.

SECOND: ("X" one box only. Attach additional page(s) if necessary.)

☒ The corporation is organized as a public benefit corporation for the following purpose or purposes:

See attached exhibit A.

☐ The corporation is organized as a mutual benefit corporation for all purposes permitted under Title 13-B or, if not for all such purposes, then for the following purpose or purposes:

THIRD: The name and registered office of the Registered Agent who must be a Maine resident, whose office is identical with the registered office; or a corporation, domestic or foreign, profit or nonprofit, having an office identical with such registered office:

Jennifer E. Hoopes

(name)

One Portland Square, P.O. Box 586, Portland, ME 04112-0586

(physical location - street (not P.O. Box), city, state and zip code)

(mailing address if different from above)

FOURTH: The number of directors (not less than 3) constituting the initial board of directors of the corporation, if the number has been designated or if the initial directors have been chosen, is _____.

The minimum number of directors (not less than 3) shall be 3 and the maximum number of directors shall be 20.

FIFTH: Members: ("X" one box only.)

☐ There shall be no members.

☒ There shall be one or more classes of members and the information required by 13-B MRSA §402 is attached. Exhibit B.

SIXTH: (Optional) ☐ (Check if this article is to apply.)

No substantial part of the activities of the Corporation shall be the carrying on of propaganda, or otherwise attempting to influence legislation, and the Corporation shall not participate in or intervene in (including the publication or distribution of statements) any political campaign on behalf of any candidate for public office.

SEVENTH: (Optional) ☒ (Check if this article is to apply.)

Other provisions of these articles including provisions for the regulation of the internal affairs of the corporation, distribution of assets on dissolution or final liquidation and the requirements of the Internal Revenue Code section 501(c) are set out in Exhibit C attached hereto and made a part hereof.

Incorporators

Jennifer E. Hoopes
(signature)
Jennifer E. Hoopes
(type or print name)

(signature)

(type or print name)

(signature)

(type or print name)

DATED December 13, 2004

Street 79 Gleckler Rd.
(residence address)

Portland, ME 04103
(city, state and zip code)

Street _____
(residence address)

(city, state and zip code)

Street _____
(residence address)

(city, state and zip code)

For Corporate Incorporators*

Name of Corporate Incorporator _____

By _____
(signature of officer)

(type or print name and capacity)

Street _____
(principal business location)

(city, state and zip code)

Acceptance of Appointment of Registered Agent

The undersigned hereby accepts the appointment as registered agent for the above-named domestic nonprofit corporation.

DATED December 13, 2004

Jennifer E. Hoopes
(signature of registered agent)

Jennifer E. Hoopes
(type or print name)

Note: If the registered agent does not sign this form, Form MNPCA-18 (13-B MRSA §304.3) must accompany this document.

***Articles are to be executed as follows:**

If a corporation is an incorporator (13-B MRSA §401), the name of the corporation should be typed or printed and signed on its behalf by an officer of the corporation. The articles of incorporation must be accompanied by a certificate of an appropriate officer of the corporation, not the person signing the articles, certifying that the person executing the articles on behalf of the corporation was duly authorized to do so.

Please remit your payment made payable to the Maine Secretary of State.

SUBMIT COMPLETED FORMS TO: CORPORATE EXAMINING SECTION, SECRETARY OF STATE,
101 STATE HOUSE STATION, AUGUSTA, ME 04333-0101

EXHIBIT A

) The Corporation is organized and shall at all times be operated exclusively for the promotion of social welfare as a non profit tax exempt organization organized under the laws of the State of Maine with all such powers as are authorized to non profit corporations by the Maine Non Profit Corporation Act. The primary activities of the corporation shall be to promote in the Maine legislature the importance of cultural resources in Maine, including museums, libraries, historic preservation, and arts; and to lobby for increased funding for Maine cultural resources.

Notwithstanding any other provision of these Articles, this Corporation shall not carry on any activities not permitted to be carried on by a corporation exempt from federal income tax under section 501(c)(4) of the Internal Revenue Code of 1986 ("Code") or the corresponding section of any future tax code.

EXHIBIT B

There shall be two classes of members: organizational and individual. Members must be interested in furthering the purposes of the Corporation and make timely payment of membership dues as established from time to time by the Board of Directors for each class. Neither class of members shall have any voting rights.

EXHIBIT C

Other provisions of these Articles:

- A. (1) It is intended that the Corporation shall be entitled to exemption from federal income tax under Section 501(c)(4) of the Internal Revenue Code. Notwithstanding any other provision of these Articles, the Corporation shall not engage in any activity or exercise any power which would deprive it of any exemption from federal income tax which the Corporation may receive under Section 501(c)(4) of the Internal Revenue Code.
- (2) No substantial part of the activities of the Corporation shall be the participation or intervention in any political campaign on behalf of or in opposition to any candidate for public office. Likewise, no substantial part of the activities of the Corporation shall be the provision of "commercial type insurance" within the meaning of Section 501(m) of the Code. Furthermore, the Corporation shall not engage in any activities that are unlawful under applicable federal, state or local laws.
- (3) The Corporation is not organized for pecuniary profit and shall not have any capital stock. All the assets and income of the Corporation shall be used exclusively for the promotion of social welfare. No part of the net earnings of the corporation shall inure to the benefit of, or be distributable to, its Members, trustees, officers, or other private persons; provided, however, that nothing contained herein shall be construed to prevent the payment by the Corporation of the reasonable compensation and expenses to Officers and employees of the Corporation for services rendered.
- B. If this Corporation be dissolved or its legal existence terminated, either voluntarily or involuntarily, or upon final liquidation of the Corporation, none of its assets shall inure to the benefit of any private individual, and after payment of its just debts and liabilities, all remaining assets shall be distributed exclusively to (a) an exempt organization under Section 501(c)(4) of the Code, as amended, or (b) to the extent such assets are not distributed in accordance with clause (a) above, such organizations as specified by the Board of Directors and subject to the limitations provided for herein.
- C. Each reference in these Articles of Incorporation to a Section in the Internal Revenue Code or the Maine Non-Profit Corporation Act shall be deemed to include a reference to such code or such act as the same may hereafter be amended and to be the corresponding provision of any such future United States Internal Revenue or Maine Non-Profit Corporation Act, as the case may be.

OMB CIRCULAR A-87 (REVISED 05/10/04)

CIRCULAR NO. A-87

Revised

TO THE HEADS OF EXECUTIVE DEPARTMENTS AND ESTABLISHMENTS

SUBJECT: Cost Principles for State, Local, and Indian Tribal Governments

1. Purpose. This Circular establishes principles and standards for determining costs for Federal awards carried out through grants, cost reimbursement contracts, and other agreements with State and local governments and federally-recognized Indian tribal governments (governmental units).
2. Authority. This Circular is issued under the authority of the Budget and Accounting Act of 1921, as amended; the Budget and Accounting Procedures Act of 1950, as amended; the Chief Financial Officers Act of 1990; Reorganization Plan No. 2 of 1970; and Executive Order No. 11541 ("Prescribing the Duties of the Office of Management and Budget and the Domestic Policy Council in the Executive Office of the President").
3. Background. As part of the governmentwide grant streamlining effort under P.L. 106-107, *Federal Financial Award Management Improvement Act of 1999*, OMB led an interagency workgroup to simplify and make consistent, to the extent feasible, the various rules used to award Federal grants. An interagency task force was established in 2001 to review existing cost principles for Federal awards to State, local, and Indian tribal governments; Colleges and Universities; and Non-Profit organizations. The task force studied Selected Items of Cost in each of the three cost principles to determine which items of costs could be stated consistently and/or more clearly. A proposed revised Circular reflecting the results of those efforts was issued on August 12, 2002 at 67 FR 52558. Extensive comments on the proposed revisions, discussions with interest groups, and related developments were considered in developing this revision.
4. Rescissions. This Circular rescinds and supersedes Circular A-87, as amended, issued May 4, 1995.
5. Policy. This Circular establishes principles and standards to provide a uniform approach for determining costs and to promote effective program delivery, efficiency, and better relationships between governmental units and the Federal Government. The principles are for determining allowable costs only. They are not intended to identify the circumstances or to dictate the extent of Federal and governmental unit participation in the financing of a particular Federal award. Provision for profit or other increment above cost is outside the scope of this Circular.
6. Definitions. Definitions of key terms used in this Circular are contained in Attachment A, Section B.

7. Required Action. Agencies responsible for administering programs that involve cost reimbursement contracts, grants, and other agreements with governmental units shall issue regulations to implement the provisions of this Circular and its Attachments.

8. OMB Responsibilities. The Office of Management and Budget (OMB) will review agency regulations and implementation of this Circular, and will provide policy interpretations and assistance to insure effective and efficient implementation. Any exceptions will be subject to approval by OMB. Exceptions will only be made in particular cases where adequate justification is presented.

9. Information Contact. Further information concerning this Circular may be obtained by contacting the Office of Federal Financial Management, Financial Standards and Reporting Branch, Office of Management and Budget, Washington, DC 20503, telephone 202-395-3993.

10. Policy Review Date. OMB Circular A-87 will have a policy review three years from the date of issuance.

11. Effective Date. This Circular is effective as follows:

- Except as otherwise provided herein, these rules are effective June 9, 2004.

OMB CIRCULAR NO. A-87

COST PRINCIPLES FOR STATE, LOCAL AND INDIAN TRIBAL GOVERNMENTS

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ATTACHMENT A

Circular No. A-87

GENERAL PRINCIPLES FOR DETERMINING ALLOWABLE COSTS

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A. Purpose and Scope

1. Objectives. This Attachment establishes principles for determining the allowable costs incurred by State, local, and federally-recognized Indian tribal governments (governmental units) under grants, cost reimbursement contracts, and other agreements with the Federal Government (collectively referred to in this Circular as "Federal awards"). The principles are for the purpose of cost determination and are not intended to identify the circumstances or dictate the extent of Federal or governmental unit participation in the financing of a particular program or project. The principles are designed to provide that Federal awards bear their fair share of cost recognized under these principles except where restricted or prohibited by law. Provision for profit or other increment above cost is outside the scope of this Circular.

2. Policy guides.

a. The application of these principles is based on the fundamental premises that:

(1) Governmental units are responsible for the efficient and effective administration of Federal awards through the application of sound management practices.

(2) Governmental units assume responsibility for administering Federal funds in a manner consistent with underlying agreements, program objectives, and the terms and conditions of the Federal award.

(3) Each governmental unit, in recognition of its own unique combination of staff, facilities, and experience, will have the primary responsibility for employing whatever form of organization and management techniques may be necessary to assure proper and efficient administration of Federal awards.

b. Federal agencies should work with States or localities which wish to test alternative mechanisms for paying costs for administering Federal programs. The Office of Management and Budget (OMB) encourages Federal agencies to test fee-for-service alternatives as a replacement for current cost-reimbursement payment methods in response to the National Performance Review's (NPR) recommendation. The NPR recommended the fee-for-service approach to reduce the burden associated with maintaining systems for charging administrative costs to Federal programs and preparing and approving cost allocation plans. This approach should also increase incentives for administrative efficiencies and improve outcomes.

3. Application.

a. These principles will be applied by all Federal agencies in determining costs incurred by governmental units under Federal awards (including subawards) except those with (1) publicly-financed educational institutions subject to OMB Circular A-21, "Cost Principles for Educational Institutions," and (2) programs administered by publicly-owned hospitals and other providers of medical care that are subject to requirements promulgated by the sponsoring Federal agencies. However, this Circular does apply to all central service and department/agency costs that are allocated or billed to those

educational institutions, hospitals, and other providers of medical care or services by other State and local government departments and agencies.

b. All subawards are subject to those Federal cost principles applicable to the particular organization concerned. Thus, if a subaward is to a governmental unit (other than a college, university or hospital), this Circular shall apply; if a subaward is to a commercial organization, the cost principles applicable to commercial organizations shall apply; if a subaward is to a college or university, Circular A-21 shall apply; if a subaward is to a hospital, the cost principles used by the Federal awarding agency for awards to hospitals shall apply, subject to the provisions of subsection A.3.a. of this Attachment; if a subaward is to some other non-profit organization, Circular A-122, "Cost Principles for Non-Profit Organizations," shall apply.

c. These principles shall be used as a guide in the pricing of fixed price arrangements where costs are used in determining the appropriate price.

d. Where a Federal contract awarded to a governmental unit incorporates a Cost Accounting Standards (CAS) clause, the requirements of that clause shall apply. In such cases, the governmental unit and the cognizant Federal agency shall establish an appropriate advance agreement on how the governmental unit will comply with applicable CAS requirements when estimating, accumulating and reporting costs under CAS-covered contracts. The agreement shall indicate that OMB Circular A-87 requirements will be applied to other Federal awards. In all cases, only one set of records needs to be maintained by the governmental unit.

e. Conditional exemptions.

(1) OMB authorizes conditional exemption from OMB administrative requirements and cost principles circulars for certain Federal programs with statutorily-authorized consolidated planning and consolidated administrative funding, that are identified by a Federal agency and approved by the head of the Executive department or establishment. A Federal agency shall consult with OMB during its consideration of whether to grant such an exemption.

(2) To promote efficiency in State and local program administration, when Federal non-entitlement programs with common purposes have specific statutorily-authorized consolidated planning and consolidated administrative funding and where most of the State agency's resources come from non-Federal sources, Federal agencies may exempt these covered State-administered, non-entitlement grant programs from certain OMB grants management requirements. The exemptions would be from all but the allocability of costs provisions of OMB Circulars A-87 (Attachment A, subsection C.3), "Cost Principles for State, Local, and Indian Tribal Governments," A-21 (Section C, subpart 4), "Cost Principles for Educational Institutions," and A-122 (Attachment A, subsection A.4), "Cost Principles for Non-Profit Organizations," and from all of the administrative requirements provisions of OMB Circular A-110, "Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations," and the agencies' grants management common rule.

(3) When a Federal agency provides this flexibility, as a prerequisite to a State's exercising this option, a State must adopt its own written fiscal and administrative requirements for expending and accounting for all funds, which are consistent with the provisions of OMB Circular A-87, and extend such policies to all subrecipients. These fiscal and administrative requirements must be sufficiently specific to ensure that: funds are used in compliance with all applicable Federal statutory and regulatory provisions, costs are reasonable and necessary for operating these programs, and funds are not be used for general expenses required to carry out other responsibilities of a State or its subrecipients.

B. Definitions

1. "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 a 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.
2. "Award" means grants, cost reimbursement contracts and other agreements between a State, local and Indian tribal government and the Federal Government.
3. "Awarding agency" means (a) with respect to a grant, cooperative agreement, or cost reimbursement contract, the Federal agency, and (b) with respect to a subaward, the party that awarded the subaward.
4. "Central service cost allocation plan" means the documentation identifying, accumulating, and allocating or developing billing rates based on the allowable costs of services provided by a governmental unit on a centralized basis to its departments and agencies. The costs of these services may be allocated or billed to users.
5. "Claim" means a written demand or written assertion by the governmental unit or grantor seeking, as a matter of right, the payment of money in a sum certain, the adjustment or interpretation of award terms, or other relief arising under or relating to the award. A voucher, invoice or other routine request for payment that is not a dispute when submitted is not a claim. Appeals, such as those filed by a governmental unit in response to questioned audit costs, are not considered claims until a final management decision is made by the Federal awarding agency.
6. "Cognizant agency" means the Federal agency responsible for reviewing, negotiating, and approving cost allocation plans or indirect cost proposals developed under this Circular on behalf of all Federal agencies. OMB publishes a listing of cognizant agencies.
7. "Common Rule" means the "Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments; Final Rule" originally issued at 53 FR 8034-8103 (March 11, 1988). Other common rules will be referred to by their specific titles.

8. "Contract" means a mutually binding legal relationship obligating the seller to furnish the supplies or services (including construction) and the buyer to pay for them. It includes all types of commitments that obligate the government to an expenditure of appropriated funds and that, except as otherwise authorized, are in writing. In addition to bilateral instruments, contracts include (but are not limited to): awards and notices of awards; job orders or task orders issued under basic ordering agreements; letter contracts; orders, such as purchase orders, under which the contract becomes effective by written acceptance or performance; and, bilateral contract modifications. Contracts do not include grants and cooperative agreements covered by 31 U.S.C. 6301 et seq.

9. "Cost" means an amount as determined on a cash, accrual, or other basis acceptable to the Federal awarding or cognizant agency. It does not include transfers to a general or similar fund.

10. "Cost allocation plan" means central service cost allocation plan, public assistance cost allocation plan, and indirect cost rate proposal. Each of these terms are further defined in this section.

11. "Cost objective" means a function, organizational subdivision, contract, grant, or other activity for which cost data are needed and for which costs are incurred. 8

12. "Federally recognized Indian tribal government" means the governing body or a governmental agency of any Indian tribe, band, nation, or other organized group or community (including any native village as defined in Section 3 of the Alaska Native Claims Settlement Act, 85 Stat. 688) certified by the Secretary of the Interior as eligible for the special programs and services provided through the Bureau of Indian Affairs.

13. "Governmental unit" means the entire State, local, or federally-recognized Indian tribal government, including any component thereof. Components of governmental units may function independently of the governmental unit in accordance with the term of the award.

14. "Grantee department or agency" means the component of a State, local, or federally-recognized Indian tribal government which is responsible for the performance or administration of all or some part of a Federal award.

15. "Indirect cost rate proposal" means the documentation prepared by a governmental unit or component thereof to substantiate its request for the establishment of an indirect cost rate as described in Attachment E of this Circular.

16. "Local government" means a county, municipality, city, town, township, local public authority, school district, special district, intrastate district, council of governments (whether or not incorporated as a non-profit corporation under State law), any other regional or interstate government entity, or any agency or instrumentality of a local government.

17. "Public assistance cost allocation plan" means a narrative description of the procedures that will be used in identifying, measuring and allocating all administrative

costs to all of the programs administered or supervised by State public assistance agencies as described in Attachment D of this Circular.

18. "State" means any of the several States of the United States, the District of Columbia, the Commonwealth of Puerto Rico, any territory or possession of the United States, or any agency or instrumentality of a State exclusive of local governments.

C. Basic Guidelines

1. Factors affecting allowability of costs. To be allowable under Federal awards, costs must meet the following general criteria:

- a. Be necessary and reasonable for proper and efficient performance and administration of Federal awards.
- b. Be allocable to Federal awards under the provisions of this Circular.
- c. Be authorized or not prohibited under State or local laws or regulations.
- d. Conform to any limitations or exclusions set forth in these principles, Federal laws, terms and conditions of the Federal award, or other governing regulations as to types or amounts of cost items.
- e. Be consistent with policies, regulations, and procedures that apply uniformly to both Federal awards and other activities of the governmental unit.
- f. Be accorded consistent treatment. A cost may not be assigned to a Federal award as a direct cost if any other cost incurred for the same purpose in like circumstances has been allocated to the Federal award as an indirect cost.
- g. Except as otherwise provided for in this Circular, be determined in accordance with generally accepted accounting principles.
- h. Not be included as a cost or used to meet cost sharing or matching requirements of any other Federal award in either the current or a prior period, except as specifically provided by Federal law or regulation.
- i. Be the net of all applicable credits.
- j. Be adequately documented.

2. Reasonable costs. A cost is reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the cost. The question of reasonableness is particularly important when governmental units or components are predominately federally-funded. In determining reasonableness of a given cost, consideration shall be given to:

- a. Whether the cost is of a type generally recognized as ordinary and necessary for the operation of the governmental unit or the performance of the Federal award.
- b. The restraints or requirements imposed by such factors as: sound business practices; arms length bargaining; Federal, State and other laws and regulations; and, terms and conditions of the Federal award.
- c. Market prices for comparable goods or services.
- d. Whether the individuals concerned acted with prudence in the circumstances considering their responsibilities to the governmental unit, its employees, the public at large, and the Federal Government.
- e. Significant deviations from the established practices of the governmental unit which may unjustifiably increase the Federal award's cost.

3. Allocable costs.

- a. A cost is allocable to a particular cost objective if the goods or services involved are chargeable or assignable to such cost objective in accordance with relative benefits received.
- b. All activities which benefit from the governmental unit's indirect cost, including unallowable activities and services donated to the governmental unit by third parties, will receive an appropriate allocation of indirect costs.
- c. Any cost allocable to a particular Federal award or cost objective under the principles provided for in this Circular may not be charged to other Federal awards to overcome fund deficiencies, to avoid restrictions imposed by law or terms of the Federal awards, or for other reasons.
- d. Where an accumulation of indirect costs will ultimately result in charges to a Federal award, a cost allocation plan will be required as described in Attachments C, D, and E.

4. Applicable credits.

- a. Applicable credits refer to those receipts or reduction of expenditure-type transactions that offset or reduce expense items allocable to Federal awards as direct or indirect costs. Examples of such transactions are: purchase discounts, rebates or allowances, recoveries or indemnities on losses, insurance refunds or rebates, and adjustments of overpayments or erroneous charges. To the extent that such credits accruing to or received by the governmental unit relate to allowable costs, they shall be credited to the Federal award either as a cost reduction or cash refund, as appropriate.
- b. In some instances, the amounts received from the Federal Government to finance activities or service operations of the governmental unit should be treated as applicable credits. Specifically, the concept of netting such credit items (including any amounts used to meet cost sharing or matching requirements) should be recognized in determining the

rates or amounts to be charged to Federal awards. (See Attachment B, item 11, "Depreciation and use allowances," for areas of potential application in the matter of Federal financing of activities.)

D. Composition of Cost

1. Total cost. The total cost of Federal awards is comprised of the allowable direct cost of the program, plus its allocable portion of allowable indirect costs, less applicable credits.
2. Classification of costs. There is no universal rule for classifying certain costs as either direct or indirect under every accounting system. A cost may be direct with respect to some specific service or function, but indirect with respect to the Federal award or other final cost objective. Therefore, it is essential that each item of cost be treated consistently in like circumstances either as a direct or an indirect cost. Guidelines for determining direct and indirect costs charged to Federal awards are provided in the sections that follow.

E. Direct Costs

1. General. Direct costs are those that can be identified specifically with a particular final cost objective.
2. Application. Typical direct costs chargeable to Federal awards are:
 - a. Compensation of employees for the time devoted and identified specifically to the performance of those awards.
 - b. Cost of materials acquired, consumed, or expended specifically for the purpose of those awards.
 - c. Equipment and other approved capital expenditures.
 - d. Travel expenses incurred specifically to carry out the award.
3. Minor items. Any direct cost of a minor amount may be treated as an indirect cost for reasons of practicality where such accounting treatment for that item of cost is consistently applied to all cost objectives.

F. Indirect Costs

1. General. Indirect costs are those: (a) incurred for a common or joint purpose benefiting more than one cost objective, and (b) not readily assignable to the cost objectives specifically benefitted, without effort disproportionate to the results achieved. The term "indirect costs," as used herein, applies to costs of this type originating in the grantee department, as well as those incurred by other departments in supplying goods, services, and facilities. To facilitate equitable distribution of indirect expenses to the cost objectives served, it may be necessary to establish a number of pools of indirect costs within a governmental unit department or in other agencies providing services to a

governmental unit department. Indirect cost pools should be distributed to benefitted cost objectives on bases that will produce an equitable result in consideration of relative benefits derived.

2. Cost allocation plans and indirect cost proposals. Requirements for development and submission of cost allocation plans and indirect cost rate proposals are contained in Attachments C, D, and E.

3. Limitation on indirect or administrative costs.

a. In addition to restrictions contained in this Circular, there may be laws that further limit the amount of administrative or indirect cost allowed.

b. Amounts not recoverable as indirect costs or administrative costs under one Federal award may not be shifted to another Federal award, unless specifically authorized by Federal legislation or regulation.

G. Interagency Services. The cost of services provided by one agency to another within the governmental unit may include allowable direct costs of the service plus a pro rate share of indirect costs. A standard indirect cost allowance equal to ten percent of the direct salary and wage cost of providing the service (excluding overtime, shift premiums, and fringe benefits) may be used in lieu of determining the actual indirect costs of the service. These services do not include centralized services included in central service cost allocation plans as described in Attachment C.

H. Required Certifications. Each cost allocation plan or indirect cost rate proposal required by Attachments C and E must comply with the following:

1. No proposal to establish a cost allocation plan or an indirect cost rate, whether submitted to a Federal cognizant agency or maintained on file by the governmental unit, shall be acceptable unless such costs have been certified by the governmental unit using the Certificate of Cost Allocation Plan or Certificate of Indirect Costs as set forth in Attachments C and E. The certificate must be signed on behalf of the governmental unit by an individual at a level no lower than chief financial officer of the governmental unit that submits the proposal or component covered by the proposal.

2. No cost allocation plan or indirect cost rate shall be approved by the Federal Government unless the plan or rate proposal has been certified. Where it is necessary to establish a cost allocation plan or an indirect cost rate and the governmental unit has not submitted a certified proposal for establishing such a plan or rate in accordance with the requirements, the Federal Government may either disallow all indirect costs or unilaterally establish such a plan or rate. Such a plan or rate may be based upon audited historical data or such other data that have been furnished to the cognizant Federal agency and for which it can be demonstrated that all unallowable costs have been excluded. When a cost allocation plan or indirect cost rate is unilaterally established by the Federal Government because of failure of the governmental unit to submit a certified proposal, the plan or rate established will be set to ensure that potentially unallowable costs will not be reimbursed.

SELECTED ITEMS OF COST

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1. Advertising and public relations costs
2. Advisory councils
3. Alcoholic beverages
4. Audit costs and related services
5. Bad debts
6. Bonding costs
7. Communication costs
8. Compensation for personal services
9. Contingency provisions
10. Defense and prosecution of criminal and civil proceedings, and claims
11. Depreciation and use allowances
12. Donations and contributions
13. Employee morale, health, and welfare costs
14. Entertainment costs
15. Equipment and other capital expenditures
16. Fines and penalties
17. Fund raising and investment management costs
18. Gains and losses on disposition of depreciable property and other capital assets and substantial relocation of Federal programs
19. General government expenses
20. Goods or services for personal use

21. Idle facilities and idle capacity
22. Insurance and indemnification
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24. Lobbying
25. Maintenance, operations, and repairs
26. Materials and supplies costs
27. Meetings and conferences
28. Memberships, subscriptions, and professional activity costs
29. Patent costs
30. Plant and homeland security costs
31. Pre-award costs
32. Professional service costs
33. Proposal costs
34. Publication and printing costs
35. Rearrangement and alteration costs
36. Reconversion costs
37. Rental costs of building and equipment
38. Royalties and other costs for the use of patents
39. Selling and marketing
40. Taxes
41. Termination costs applicable to sponsored agreements
42. Training costs
43. Travel costs.

Sections 1 through 43 provide principles to be applied in establishing the allowability or unallowability of certain items of cost. These principles apply whether a cost is treated as direct or indirect. A cost is allowable for Federal reimbursement only to the extent of

benefits received by Federal awards and its conformance with the general policies and principles stated in Attachment A to this Circular. Failure to mention a particular item of cost in these sections is not intended to imply that it is either allowable or unallowable; rather, determination of allowability in each case should be based on the treatment or standards provided for similar or related items of cost.

1. Advertising and public relations costs.

- a. The term advertising costs means the costs of advertising media and corollary administrative costs.
Advertising media include magazines, newspapers, radio and television, direct mail, exhibits, electronic or computer transmittals, and the like.
- b. The term public relations includes community relations and means those activities dedicated to maintaining the image of the governmental unit or maintaining or promoting understanding and favorable relations with the community or public at large or any segment of the public.
- c. The only allowable advertising costs are those which are solely for:
 - (1) The recruitment of personnel required for the performance by the governmental unit of obligations arising under a Federal award ;
 - (2) The procurement of goods and services for the performance of a Federal award;
 - (3) The disposal of scrap or surplus materials acquired in the performance of a Federal award except when governmental units are reimbursed for disposal costs at a predetermined amount; or
 - (4) Other specific purposes necessary to meet the requirements of the Federal award.
- d. The only allowable public relations costs are:
 - (1) Costs specifically required by the Federal award;
 - (2) Costs of communicating with the public and press pertaining to specific activities or accomplishments which result from performance of Federal awards (these costs are considered necessary as part of the outreach effort for the Federal award); or
 - (3) Costs of conducting general liaison with news media and government public relations officers, to the extent that such activities are limited to communication and liaison necessary keep the public informed on matters of public concern, such as notices of Federal contract/grant awards, financial matters, etc.
- e. Costs identified in subsections c and d if incurred for more than one Federal award or for both sponsored work and other work of the governmental unit, are allowable to the extent that the principles in Attachment A, sections E. ("Direct Costs") and F. ("Indirect Costs") are observed.
- f. Unallowable advertising and public relations costs include the following:
 - (1) All advertising and public relations costs other than as specified in subsections c, d, and e;
 - (2) Costs of meetings, conventions, convocations, or other events related to other activities of the governmental unit, including:
 - (a) Costs of displays, demonstrations, and exhibits;
 - (b) Costs of meeting rooms, hospitality suites, and other special facilities used in conjunction with shows and other special events; and
 - (c) Salaries and wages of employees engaged in setting up and displaying exhibits, making demonstrations, and providing briefings;
 - (3) Costs of promotional items and memorabilia, including models, gifts, and souvenirs;
 - (4) Costs of advertising and public relations designed solely to promote the governmental unit.

2. Advisory councils. Costs incurred by advisory councils or committees are allowable as a direct cost where authorized by the Federal awarding agency or as an indirect cost where allocable to Federal awards.

3. Alcoholic beverages. Costs of alcoholic beverages are unallowable.

4. Audit costs and related services.

a. The costs of audits required by , and performed in accordance with, the Single Audit Act, as implemented by Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations" are allowable. Also see 31 USC 7505(b) and section 230 ("Audit Costs") of Circular A-133.

b. Other audit costs are allowable if included in a cost allocation plan or indirect cost proposal, or if specifically approved by the awarding agency as a direct cost to an award

c. The cost of agreed-upon procedures engagements to monitor subrecipients who are exempted from A-133 under section 200(d) are allowable, subject to the conditions listed in A-133, section 230 (b)(2).

5. Bad debts. Bad debts, including losses (whether actual or estimated) arising from uncollectable accounts and other claims, related collection costs, and related legal costs, are unallowable.

6. Bonding costs.

a. Bonding costs arise when the Federal Government requires assurance against financial loss to itself or others by reason of the act or default of the governmental unit. They arise also in instances where the governmental unit requires similar assurance. Included are such bonds as bid, performance, payment, advance payment, infringement, and fidelity bonds.

b. Costs of bonding required pursuant to the terms of the award are allowable.

c. Costs of bonding required by the governmental unit in the general conduct of its operations are allowable to the extent that such bonding is in accordance with sound business practice and the rates and premiums are reasonable under the circumstances.

7. Communication costs. Costs incurred for telephone services, local and long distance telephone calls, telegrams, postage, messenger, electronic or computer transmittal services and the like are allowable.

8. Compensation for personal services.

a. General. Compensation for personnel services includes all remuneration, paid currently or accrued, for services rendered during the period of performance under Federal awards, including but not necessarily limited to wages, salaries, and fringe benefits. The costs of such compensation are allowable to the extent that they satisfy the specific requirements of this Circular, and that the total compensation for individual employees:

(1) Is reasonable for the services rendered and conforms to the established policy of the governmental unit consistently applied to both Federal and non-Federal activities;

(2) Follows an appointment made in accordance with a governmental unit's laws and rules and meets merit system or other requirements required by Federal law, where applicable; and

(3) Is determined and supported as provided in subsection h.

b. Reasonableness. Compensation for employees engaged in work on Federal awards will be considered reasonable to the extent that it is consistent with that paid for similar work in other activities of the governmental unit. In cases where the kinds of employees required for Federal awards are not found in the other activities of the governmental unit, compensation will be considered reasonable to the extent that it is comparable to that paid for similar work in the labor market in which the employing government competes for the kind of employees involved. Compensation surveys providing data representative of the labor market involved will be an acceptable basis for evaluating reasonableness.

c. Unallowable costs. Costs which are unallowable under other sections of these principles shall not be allowable under this section solely on the basis that they constitute personnel compensation.

d. Fringe benefits.

(1) Fringe benefits are allowances and services provided by employers to their employees as compensation in addition to regular salaries and wages. Fringe benefits include, but are not limited to, the costs of leave, employee insurance, pensions, and unemployment benefit plans. Except as provided elsewhere in these principles, the costs of fringe benefits are allowable to the extent that the benefits are reasonable and are required by law, governmental unit-employee agreement, or an established policy of the governmental unit.

(2) The cost of fringe benefits in the form of regular compensation paid to employees during periods of authorized absences from the job, such as for annual leave, sick leave, holidays, court leave, military leave, and other similar benefits, are allowable if: (a) they are provided under established written leave policies; (b) the costs are equitably allocated to all related activities, including Federal awards; and, (c) the accounting basis (cash or accrual) selected for costing each type of leave is consistently followed by the governmental unit.

(3) When a governmental unit uses the cash basis of accounting, the cost of leave is recognized in the period that the leave is taken and paid for. Payments for unused leave when an employee retires or terminates employment are allowable in the year of payment provided they are allocated as a general administrative expense to all activities of the governmental unit or component.

(4) The accrual basis may be only used for those types of leave for which a liability as defined by Generally Accepted Accounting Principles (GAAP) exists when the leave is earned. When a governmental unit uses the accrual basis of accounting, in accordance with GAAP, allowable leave costs are the lesser of the amount accrued or funded.

(5) The cost of fringe benefits in the form of employer contributions or expenses for social security; employee life, health, unemployment, and worker's compensation insurance (except as indicated in section 22, Insurance and indemnification); pension plan costs (see subsection e.); and other similar benefits are allowable, provided such benefits are granted under established written policies. Such benefits, whether treated as indirect costs or as direct costs, shall be allocated to Federal awards and all other activities in a manner consistent with the pattern of benefits attributable to the individuals or group(s) of employees whose salaries and wages are chargeable to such Federal awards and other activities.

e. Pension plan costs. Pension plan costs may be computed using a pay-as-you-go method or an acceptable actuarial cost method in accordance with established written policies of the governmental unit.

(1) For pension plans financed on a pay-as-you-go method, allowable costs will be limited to those representing actual payments to retirees or their beneficiaries.

(2) Pension costs calculated using an actuarial cost-based method recognized by GAAP are allowable for a given fiscal year if they are funded for that year within six months after the end of that year. Costs funded after the six month period (or a later period agreed to by the cognizant agency) are allowable in the year funded. The cognizant agency may agree to an extension of the six month period if an appropriate adjustment is made to compensate for the timing of the charges to the Federal Government and related Federal reimbursement and the governmental unit's contribution to the pension fund. Adjustments may be made by cash refund or other equitable procedures to compensate the Federal Government for the time value of Federal reimbursements in excess of contributions to the pension fund.

(3) Amounts funded by the governmental unit in excess of the actuarially determined amount for a fiscal year may be used as the governmental unit's contribution in future periods.

(4) When a governmental unit converts to an acceptable actuarial cost method, as defined by GAAP, and funds pension costs in accordance with this method, the unfunded liability at the time of conversion shall be allowable if amortized over a period of years in accordance with GAAP.

(5) The Federal Government shall receive an equitable share of any previously allowed pension costs (including earnings thereon) which revert or inure to the governmental unit in the form of a refund, withdrawal, or other credit.

f. Post-retirement health benefits. Post-retirement health benefits (PRHB) refers to costs of health insurance or health services not included in a pension plan covered by subsection e. for retirees and their spouses, dependents, and survivors. PRHB costs may be computed using a pay-as-you-go method or an acceptable actuarial cost method in accordance with established written policies of the governmental unit.

(1) For PRHB financed on a pay as-you-go method, allowable costs will be limited to those representing actual payments to retirees or their beneficiaries.

(2) PRHB costs calculated using an actuarial cost method recognized by GAAP are allowable if they are funded for that year within six months after the end of that year. Costs funded after the six month period (or a later period agreed to by the cognizant agency) are allowable in the year funded. The cognizant agency may agree to an extension of the six month period if an appropriate adjustment is made to compensate for the timing of the charges to the Federal Government and related Federal reimbursements and the governmental unit's contributions to the PRHB fund. Adjustments may be made by cash refund, reduction in current year's PRHB costs, or other equitable procedures to compensate the Federal Government for the time value of Federal reimbursements in excess of contributions to the PRHB fund.

(3) Amounts funded in excess of the actuarially determined amount for a fiscal year may be used as the government's contribution in a future period.

(4) When a governmental unit converts to an acceptable actuarial cost method and funds PRHB costs in accordance with this method, the initial unfunded liability attributable to prior years shall be allowable if amortized over a period of years in accordance with GAAP, or, if no such GAAP period exists, over a period negotiated with the cognizant agency.

(5) To be allowable in the current year, the PRHB costs must be paid either to:

(a) An insurer or other benefit provider as current year costs or premiums, or

(b) An insurer or trustee to maintain a trust fund or reserve for the sole purpose of providing post-retirement benefits to retirees and other beneficiaries.

(6) The Federal Government shall receive an equitable share of any amounts of previously allowed post-retirement benefit costs (including earnings thereon) which revert or inure to the governmental unit in the form of a refund, withdrawal, or other credit.

g. Severance pay.

(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.

h. Support of salaries and wages. These standards regarding time distribution are in addition to the standards for payroll documentation.

(1) Charges to Federal awards for salaries and wages, whether treated as direct or indirect costs, will be based on payrolls documented in accordance with generally accepted practice of the governmental unit and approved by a responsible official(s) of the governmental unit.

(2) No further documentation is required for the salaries and wages of employees who work in a single indirect cost activity.

(3) Where employees are expected to work solely on a single Federal award or cost objective, charges for their salaries and wages will be supported by periodic certifications that the employees worked solely on that program for the period covered by the certification. These certifications will be prepared at least semi-annually and will be signed by the employee or supervisory official having first hand knowledge of the work performed by the employee.

(4) Where employees work on multiple activities or cost objectives, a distribution of their salaries or wages will be supported by personnel activity reports or equivalent documentation which meets the standards in subsection (5) unless a statistical sampling system (see subsection (6)) or other substitute system has been approved by the cognizant Federal agency. Such documentary support will be required where employees work on:

- (a) More than one Federal award,
- (b) A Federal award and a non-Federal award,
- (c) An indirect cost activity and a direct cost activity,
- (d) Two or more indirect activities which are allocated using different allocation bases, or
- (e) An unallowable activity and a direct or indirect cost activity.

(5) Personnel activity reports or equivalent documentation must meet the following standards:

- (a) They must reflect an after-the-fact distribution of the actual activity of each employee,
- (b) They must account for the total activity for which each employee is compensated,
- (c) They must be prepared at least monthly and must coincide with one or more pay periods, and
- (d) They must be signed by the employee.

(e) Budget estimates or other distribution percentages determined before the services are performed do not qualify as support for charges to Federal awards but may be used for interim accounting purposes, provided that:

(i) The governmental unit's system for establishing the estimates produces reasonable approximations of the activity actually performed;

(ii) At least quarterly, comparisons of actual costs to budgeted distributions based on the monthly activity reports are made. Costs charged to Federal awards to reflect adjustments made as a result of the activity actually performed may be recorded annually if the quarterly comparisons show the differences between budgeted and actual costs are less than ten percent; and

(iii) The budget estimates or other distribution percentages are revised at least quarterly, if necessary, to reflect changed circumstances.

(6) Substitute systems for allocating salaries and wages to Federal awards may be used in place of activity reports. These systems are subject to approval if required by the cognizant agency. Such systems may include, but are not limited to, random moment sampling, case counts, or other quantifiable measures of employee effort.

(a) Substitute systems which use sampling methods (primarily for Temporary Assistance to Needy Families (TANF), Medicaid, and other public assistance programs) must meet acceptable statistical sampling standards including:

(i) The sampling universe must include all of the employees whose salaries and wages are to be allocated based on sample results except as provided in subsection (c);

(ii) The entire time period involved must be covered by the sample; and

(iii) The results must be statistically valid and applied to the period being sampled.

(b) Allocating charges for the sampled employees' supervisors, clerical and support staffs, based on the results of the sampled employees, will be acceptable.

(c) Less than full compliance with the statistical sampling standards noted in subsection (a) may be accepted by the cognizant agency if it concludes that the amounts to be allocated to Federal awards will be minimal, or if it concludes that the system proposed by the governmental unit will result in lower costs to Federal awards than a system which complies with the standards.

(7) Salaries and wages of employees used in meeting cost sharing or matching requirements of Federal awards must be supported in the same manner as those claimed as allowable costs under Federal awards.

i. Donated services.

(1) Donated or volunteer services may be furnished to a governmental unit by professional and technical personnel, consultants, and other skilled and unskilled labor. The value of these services is not reimbursable either as a direct or indirect cost. However, the value of donated services may be used to meet cost sharing or matching requirements in accordance with the provisions of the Common Rule.

(2) The value of donated services utilized in the performance of a direct cost activity shall, when material in amount, be considered in the determination of the governmental unit's indirect costs or rate(s) and, accordingly, shall be allocated a proportionate share of applicable indirect costs.

(3) To the extent feasible, donated services will be supported by the same methods used by the governmental unit to support the allocability of regular personnel services.

9. Contingency provisions. Contributions to a contingency reserve or any similar provision made for events the occurrence of which cannot be foretold with certainty as to time, intensity, or with an assurance of their happening, are unallowable. The term "contingency reserve" excludes self-insurance reserves (see Attachment B, section 22.c.), pension plan reserves (see Attachment B, section 8.e.), and post-retirement health and other benefit reserves (see Attachment B, section 8.f.) computed using acceptable actuarial cost methods.

10. Defense and prosecution of criminal and civil proceedings, and claims.

a. The following costs are unallowable for contracts covered by 10 U.S.C. 2324(k), "Allowable costs under defense contracts."

(1) Costs incurred in defense of any civil or criminal fraud proceeding or similar proceeding (including filing of false certification brought by the United States where the contractor is found liable or has pleaded nolo contendere to a charge of fraud or similar proceeding (including filing of a false certification)).

(2) Costs incurred by a contractor in connection with any criminal, civil or administrative proceedings commenced by the United States or a State to the extent provided in 10 U.S.C. 2324(k).

b. Legal expenses required in the administration of Federal programs are allowable. Legal expenses for prosecution of claims against the Federal Government are unallowable.

11. Depreciation and use allowances.

a. Depreciation and use allowances are means of allocating the cost of fixed assets to periods benefiting from asset use. Compensation for the use of fixed assets on hand may be made through depreciation or use allowances. A combination of the two methods may not be used in connection with a single class of fixed assets (e.g., buildings, office equipment, computer equipment, etc.) except as provided for in subsection g. Except for enterprise funds and internal service funds that are included as part of a State/local cost

allocation plan, classes of assets shall be determined on the same basis used for the government-wide financial statements.

b. The computation of depreciation or use allowances shall be based on the acquisition cost of the assets involved. Where actual cost records have not been maintained, a reasonable estimate of the original acquisition cost may be used. The value of an asset donated to the governmental unit by an unrelated third party shall be its fair market value at the time of donation. Governmental or quasi-governmental organizations located within the same State shall not be considered unrelated third parties for this purpose.

c. The computation of depreciation or use allowances will exclude:

(1) The cost of land;

(2) Any portion of the cost of buildings and equipment borne by or donated by the Federal Government irrespective of where title was originally vested or where it presently resides; and

(3) Any portion of the cost of buildings and equipment contributed by or for the governmental unit, or a related donor organization, in satisfaction of a matching requirement.

d. Where the depreciation method is followed, the period of useful service (useful life) established in each case for usable capital assets must take into consideration such factors as type of construction, nature of the equipment used, historical usage patterns, technological developments, and the renewal and replacement policies of the governmental unit followed for the individual items or classes of assets involved. In the absence of clear evidence indicating that the expected consumption of the asset will be significantly greater in the early portions than in the later portions of its useful life, the straight line method of depreciation shall be used.

Depreciation methods once used shall not be changed unless approved by the Federal cognizant or awarding agency. When the depreciation method is introduced for application to an asset previously subject to a use allowance, the annual depreciation charge thereon may not exceed the amount that would have resulted had the depreciation method been in effect from the date of acquisition of the asset. The combination of use allowances and depreciation applicable to the asset shall not exceed the total acquisition cost of the asset or fair market value at time of donation.

e. When the depreciation method is used for buildings, a building's shell may be segregated from the major component of the building (e.g., plumbing system, heating, and air conditioning system, etc.) and each major component depreciated over its estimated useful life, or the entire building (i.e., the shell and all components) may be treated as a single asset and depreciated over a single useful life.

f. Where the use allowance method is followed, the use allowance for buildings and improvements (including land improvements, such as paved parking areas, fences, and sidewalks) will be computed at an annual rate not exceeding two percent of acquisition costs. The use allowance for equipment will be computed at an annual rate not exceeding $6\frac{2}{3}$ percent of acquisition cost. When the use allowance method is used for buildings, the entire building must be treated as a single asset; the building's components (e.g.,

plumbing system, heating and air condition, etc.) cannot be segregated from the building's shell.

The two percent limitation, however, need not be applied to equipment which is merely attached or fastened to the building but not permanently fixed to it and which is used as furnishings or decorations or for specialized purposes (e.g., dentist chairs and dental treatment units, counters, laboratory benches bolted to the floor, dishwashers, modular furniture, carpeting, etc.). Such equipment will be considered as not being permanently fixed to the building if it can be removed without the destruction of, or need for costly or extensive alterations or repairs, to the building or the equipment. Equipment that meets these criteria will be subject to the 6 2/3 percent equipment use allowance limitation.

g. A reasonable use allowance may be negotiated for any assets that are considered to be fully depreciated, after taking into consideration the amount of depreciation previously charged to the government, the estimated useful life remaining at the time of negotiation, the effect of any increased maintenance charges, decreased efficiency due to age, and any other factors pertinent to the utilization of the asset for the purpose contemplated.

h. Charges for use allowances or depreciation must be supported by adequate property records. Physical inventories must be taken at least once every two years (a statistical sampling approach is acceptable) to ensure that assets exist, and are in use. Governmental units will manage equipment in accordance with State laws and procedures. When the depreciation method is followed, depreciation records indicating the amount of depreciation taken each period must also be maintained.

12. Donations and contributions.

a. Contributions or donations rendered. Contributions or donations, including cash, property, and services, made by the governmental unit, regardless of the recipient, are unallowable.

b. Donated services received:

(1) Donated or volunteer services may be furnished to a governmental unit by professional and technical personnel, consultants, and other skilled and unskilled labor. The value of these services is not reimbursable either as a direct or indirect cost.

However, the value of donated services may be used to meet cost sharing or matching requirements in accordance with the Federal Grants Management Common Rule.

(2) The value of donated services utilized in the performance of a direct cost activity shall, when material in amount, be considered in the determination of the governmental unit's indirect costs or rate(s) and, accordingly, shall be allocated a proportionate share of applicable indirect costs.

(3) To the extent feasible, donated services will be supported by the same methods used by the governmental unit to support the allocability of regular personnel services.

13. Employee morale, health, and welfare costs.

a. The costs of employee information publications, health or first-aid clinics and/or infirmaries, recreational activities, employee counseling services, and any other expenses incurred in accordance with the governmental unit's established practice or custom for the

improvement of working conditions, employer-employee relations, employee morale, and employee performance are allowable.

b. Such costs will be equitably apportioned to all activities of the governmental unit. Income generated from any of these activities will be offset against expenses.

14. Entertainment. Costs of entertainment, including amusement, diversion, and social activities and any costs directly associated with such costs (such as tickets to shows or sports events, meals, lodging, rentals, transportation, and gratuities) are unallowable.

15. Equipment and other capital expenditures.

a. For purposes of this subsection 15, the following definitions apply:

(1) "Capital Expenditures" means expenditures for the acquisition cost of capital assets (equipment, buildings, land), or expenditures to make improvements to capital assets that materially increase their value or useful life. Acquisition cost means the cost of the asset including the cost to put it in place. Acquisition cost for equipment, for example, means the net invoice price of the equipment, including the cost of any modifications, attachments, accessories, or auxiliary apparatus necessary to make it usable for the purpose for which it is acquired. Ancillary charges, such as taxes, duty, protective in transit insurance, freight, and installation may be included in, or excluded from the acquisition cost in accordance with the governmental unit's regular accounting practices.

(2) "Equipment" means an article of nonexpendable, tangible personal property having a useful life of more than one year and an acquisition cost which equals or exceeds the lesser of the capitalization level established by the governmental unit for financial statement purposes, or \$5000.

(3) "Special purpose equipment" means equipment which is used only for research, medical, scientific, or other technical activities. Examples of special purpose equipment include microscopes, x-ray machines, surgical instruments, and spectrometers.

(4) "General purpose equipment" means equipment, which is not limited to research, medical, scientific or other technical activities. Examples include office equipment and furnishings, modular offices, telephone networks, information technology equipment and systems, air conditioning equipment, reproduction and printing equipment, and motor vehicles.

b. The following rules of allowability shall apply to equipment and other capital expenditures:

(1) Capital expenditures for general purpose equipment, buildings, and land are unallowable as direct charges, except where approved in advance by the awarding agency.

(2) Capital expenditures for special purpose equipment are allowable as direct costs, provided that items with a unit cost of \$5000 or more have the prior approval of the awarding agency.

(3) Capital expenditures for improvements to land, buildings, or equipment which materially increase their value or useful life are unallowable as a direct cost except with the prior approval of the awarding agency.

(4) When approved as a direct charge pursuant to Attachment B, section 15.b (1), (2), and (3) above, capital expenditures will be charged in the period in which the expenditure is

incurred, or as otherwise determined appropriate and negotiated with the awarding agency. In addition, Federal awarding agencies are authorized at their option to waive or delegate the prior approval requirement.

(5) Equipment and other capital expenditures are unallowable as indirect costs. However, see section 11, Depreciation and use allowance, for rules on the allowability of use allowances or depreciation on buildings, capital improvements, and equipment. Also, see section 37, Rental costs, concerning the allowability of rental costs for land, buildings, and equipment.

(6) The unamortized portion of any equipment written off as a result of a change in capitalization levels may be recovered by continuing to claim the otherwise allowable use allowances or depreciation on the equipment, or by amortizing the amount to be written off over a period of years negotiated with the cognizant agency.

(7) When replacing equipment purchased in whole or in part with Federal funds, the governmental unit may use the equipment to be replaced as a trade-in or sell the property and use the proceeds to offset the cost of the replacement property.

16. Fines and penalties. Fines, penalties, damages, and other settlements resulting from violations (or alleged violations) of, or failure of the governmental unit to comply with, Federal, State, local, or Indian tribal laws and regulations are unallowable except when incurred as a result of compliance with specific provisions of the Federal award or written instructions by the awarding agency authorizing in advance such payments.

17. Fund raising and investment management costs.

a. Costs of organized fund raising, including financial campaigns, solicitation of gifts and bequests, and similar expenses incurred to raise capital or obtain contributions are unallowable, regardless of the purpose for which the funds will be used.

b. Costs of investment counsel and staff and similar expenses incurred to enhance income from investments are unallowable. However, such costs associated with investments covering pension, self-insurance, or other funds which include Federal participation allowed by this Circular are allowable.

c. Fund raising and investment activities shall be allocated an appropriate share of indirect costs under the conditions described in subsection C.3.b. of Attachment A.

18. Gains and losses on disposition of depreciable property and other capital assets and substantial relocation of Federal programs.

a. (1) Gains and losses on the sale, retirement, or other disposition of depreciable property shall be included in the year in which they occur as credits or charges to the asset cost grouping(s) in which the property was included. The amount of the gain or loss to be included as a credit or charge to the appropriate asset cost grouping(s) shall be the difference between the amount realized on the property and the undepreciated basis of the property.

(2) Gains and losses on the disposition of depreciable property shall not be recognized as a separate credit or charge under the following conditions:

(a) The gain or loss is processed through a depreciation account and is reflected in the depreciation allowable under sections 11 and 15.

(b) The property is given in exchange as part of the purchase price of a similar item and the gain or loss is taken into account in determining the depreciation cost basis of the new item.

(c) A loss results from the failure to maintain permissible insurance, except as otherwise provided in subsection 22.d.

(d) Compensation for the use of the property was provided through use allowances in lieu of depreciation.

b. Substantial relocation of Federal awards from a facility where the Federal Government participated in the financing to another facility prior to the expiration of the useful life of the financed facility requires Federal agency approval. The extent of the relocation, the amount of the Federal participation in the financing, and the depreciation charged to date may require negotiation of space charges for Federal awards.

c. Gains or losses of any nature arising from the sale or exchange of property other than the property covered in subsection a., e.g., land or included in the fair market value used in any adjustment resulting from a relocation of Federal awards covered in subsection b. shall be excluded in computing Federal award costs.

19. General government expenses.

a. The general costs of government are unallowable (except as provided in Attachment B, section 43, Travel costs). These include:

(1) Salaries and expenses of the Office of the Governor of a State or the chief executive of a political subdivision or the chief executive of federally-recognized Indian tribal government;

(2) Salaries and other expenses of a State legislature, tribal council, or similar local governmental body, such as a county supervisor, city council, school board, etc., whether incurred for purposes of legislation or executive direction;

(3) Costs of the judiciary branch of a government;

(4) Costs of prosecutorial activities unless treated as a direct cost to a specific program if authorized by program statute or regulation (however, this does not preclude the allowability of other legal activities of the Attorney General); and

(5) Costs of other general types of government services normally provided to the general public, such as fire and police, unless provided for as a direct cost under a program statute or regulation.

b. For federally-recognized Indian tribal governments and Councils Of Governments (COGs), the portion of salaries and expenses directly attributable to managing and operating Federal programs by the chief executive and his staff is allowable

20. Goods or services for personal use. Costs of goods or services for personal use of the governmental unit's employees are unallowable regardless of whether the cost is reported as taxable income to the employees.

21. Idle facilities and idle capacity.

a. As used in this section the following terms have the meanings set forth below:

(1) "Facilities" means land and buildings or any portion thereof, equipment individually or collectively, or any other tangible capital asset, wherever located, and whether owned or leased by the governmental unit.

(2) "Idle facilities" means completely unused facilities that are excess to the governmental unit's current needs.

(3) "Idle capacity" means the unused capacity of partially used facilities. It is the difference between: (a) that which a facility could achieve under 100 percent operating time on a one-shift basis less operating interruptions resulting from time lost for repairs, setups, unsatisfactory materials, and other normal delays; and (b) the extent to which the facility was actually used to meet demands during the accounting period. A multi-shift basis should be used if it can be shown that this amount of usage would normally be expected for the type of facility involved.

(4) "Cost of idle facilities or idle capacity" means costs such as maintenance, repair, housing, rent, and other related costs, e.g., insurance, interest, property taxes and depreciation or use allowances.

b. The costs of idle facilities are unallowable except to the extent that:

(1) They are necessary to meet fluctuations in workload; or

(2) Although not necessary to meet fluctuations in workload, they were necessary when acquired and are now idle because of changes in program requirements, efforts to achieve more economical operations, reorganization, termination, or other causes which could not have been reasonably foreseen. Under the exception stated in this subsection, costs of idle facilities are allowable for a reasonable period of time, ordinarily not to exceed one year, depending on the initiative taken to use, lease, or dispose of such facilities.

c. The costs of idle capacity are normal costs of doing business and are a factor in the normal fluctuations of usage or indirect cost rates from period to period. Such costs are allowable, provided that the capacity is reasonably anticipated to be necessary or was originally reasonable and is not subject to reduction or elimination by use on other Federal awards, subletting, renting, or sale, in accordance with sound business, economic, or security practices. Widespread idle capacity throughout an entire facility or among a group of assets having substantially the same function may be considered idle facilities.

22. Insurance and indemnification.

a. Costs of insurance required or approved and maintained, pursuant to the Federal award, are allowable.

b. Costs of other insurance in connection with the general conduct of activities are allowable subject to the following limitations:

(1) Types and extent and cost of coverage are in accordance with the governmental unit's policy and sound business practice.

(2) Costs of insurance or of contributions to any reserve covering the risk of loss of, or damage to, Federal Government property are unallowable except to the extent that the awarding agency has specifically required or approved such costs.

c. Actual losses which could have been covered by permissible insurance (through a self-insurance program or otherwise) are unallowable, unless expressly provided for in the Federal award or as described below. However, the Federal Government will participate in actual losses of a self insurance fund that are in excess of reserves. Costs incurred because of losses not covered under nominal deductible insurance coverage provided in keeping with sound management practice, and minor losses not covered by insurance, such as spoilage, breakage, and disappearance of small hand tools, which occur in the ordinary course of operations, are allowable.

d. Contributions to a reserve for certain self-insurance programs including workers compensation, unemployment compensation, and severance pay are allowable subject to the following provisions:

(1) The type of coverage and the extent of coverage and the rates and premiums would have been allowed had insurance (including reinsurance) been purchased to cover the risks. However, provision for known or reasonably estimated self-insured liabilities, which do not become payable for more than one year after the provision is made, shall not exceed the discounted present value of the liability. The rate used for discounting the liability must be determined by giving consideration to such factors as the governmental unit's settlement rate for those liabilities and its investment rate of return.

(2) Earnings or investment income on reserves must be credited to those reserves.

(3) Contributions to reserves must be based on sound actuarial principles using historical experience and reasonable assumptions. Reserve levels must be analyzed and updated at least biennially for each major risk being insured and take into account any reinsurance, coinsurance, etc. Reserve levels related to employee-related coverages will normally be limited to the value of claims (a) submitted and adjudicated but not paid, (b) submitted but not adjudicated, and (c) incurred but not submitted. Reserve levels in excess of the amounts based on the above must be identified and justified in the cost allocation plan or indirect cost rate proposal.

(4) Accounting records, actuarial studies, and cost allocations (or billings) must recognize any significant differences due to types of insured risk and losses generated by the various insured activities or agencies of the governmental unit. If individual departments or agencies of the governmental unit experience significantly different levels of claims for a particular risk, those differences are to be recognized by the use of separate allocations or other techniques resulting in an equitable allocation.

(5) Whenever funds are transferred from a self-insurance reserve to other accounts (e.g., general fund), refunds shall be made to the Federal Government for its share of funds transferred, including earned or imputed interest from the date of transfer.

e. Actual claims paid to or on behalf of employees or former employees for workers' compensation, unemployment compensation, severance pay, and similar employee benefits (e.g., subsection 8.f. for post retirement health benefits), are allowable in the year of payment provided (1) the governmental unit follows a consistent costing policy and (2) they are allocated as a general administrative expense to all activities of the governmental unit.

f. Insurance refunds shall be credited against insurance costs in the year the refund is received.

g. Indemnification includes securing the governmental unit against liabilities to third persons and other losses not compensated by insurance or otherwise. The Federal Government is obligated to indemnify the governmental unit only to the extent expressly provided for in the Federal award, except as provided in subsection d.

h. Costs of commercial insurance that protects against the costs of the contractor for correction of the contractor's own defects in materials or workmanship are unallowable.

23. Interest.

a. Costs incurred for interest on borrowed capital or the use of a governmental unit's own funds, however represented, are unallowable except as specifically provided in subsection b. or authorized by Federal legislation.

b. Financing costs (including interest) paid or incurred which are associated with the otherwise allowable costs of building acquisition, construction, or fabrication, reconstruction or remodeling completed on or after October 1, 1980 is allowable subject to the conditions in (1) through (4) of this section 23.b. Financing costs (including interest) paid or incurred on or after September 1, 1995 for land or associated with otherwise allowable costs of equipment is allowable, subject to the conditions in (1) through (4).

(1) The financing is provided (from other than tax or user fee sources) by a bona fide third party external to the governmental unit;

(2) The assets are used in support of Federal awards;

(3) Earnings on debt service reserve funds or interest earned on borrowed funds pending payment of the construction or acquisition costs are used to offset the current period's cost or the capitalized interest, as appropriate. Earnings subject to being reported to the Federal Internal Revenue Service under arbitrage requirements are excludable.

(4) For debt arrangements over \$1 million, unless the governmental unit makes an initial equity contribution to the asset purchase of 25 percent or more, the governmental unit

shall reduce claims for interest cost by an amount equal to imputed interest earnings on excess cash flow, which is to be calculated as follows. Annually, non-Federal entities shall prepare a cumulative (from the inception of the project) report of monthly cash flows that includes inflows and outflows, regardless of the funding source. Inflows consist of depreciation expense, amortization of capitalized construction interest, and annual interest cost. For cash flow calculations, the annual inflow figures shall be divided by the number of months in the year (i.e., usually 12) that the building is in service for monthly amounts. Outflows consist of initial equity contributions, debt principal payments (less the pro rata share attributable to the unallowable costs of land) and interest payments. Where cumulative inflows exceed cumulative outflows, interest shall be calculated on the excess inflows for that period and be treated as a reduction to allowable interest cost. The rate of interest to be used to compute earnings on excess cash flows shall be the three-month Treasury bill closing rate as of the last business day of that month.

(5) Interest attributable to fully depreciated assets is unallowable.

24. Lobbying.

a. General. The cost of certain influencing activities associated with obtaining grants, contracts, cooperative agreements, or loans is an unallowable cost. Lobbying with respect to certain grants, contracts, cooperative agreements, and loans shall be governed by the common rule, "New Restrictions on Lobbying" published at 55 FR 6736 (February 26, 1990), including definitions, and the Office of Management and Budget "Government-wide Guidance for New Restrictions on Lobbying" and notices published at 54 FR 52306 (December 20, 1989), 55 FR 24540 (June 15, 1990), and 57 FR 1772 (January 15, 1992), respectively.

b. Executive lobbying costs. Costs incurred in attempting to improperly influence either directly or indirectly, an employee or officer of the Executive Branch of the Federal Government to give consideration or to act regarding a sponsored agreement or a regulatory matter are unallowable. Improper influence means any influence that induces or tends to induce a Federal employee or officer to give consideration or to act regarding a federally-sponsored agreement or regulatory matter on any basis other than the merits of the matter.

25. Maintenance, operations, and repairs. Unless prohibited by law, the cost of utilities, insurance, security, janitorial services, elevator service, upkeep of grounds, necessary maintenance, normal repairs and alterations, and the like are allowable to the extent that they: (1) keep property (including Federal property, unless otherwise provided for) in an efficient operating condition, (2) do not add to the permanent value of property or appreciably prolong its intended life, and (3) are not otherwise included in rental or other charges for space. Costs which add to the permanent value of property or appreciably prolong its intended life shall be treated as capital expenditures (see sections 11 and 15).

26. Materials and supplies costs.

- a. Costs incurred for materials, supplies, and fabricated parts necessary to carry out a Federal award are allowable.
- b. Purchased materials and supplies shall be charged at their actual prices, net of applicable credits. Withdrawals from general stores or stockrooms should be charged at their actual net cost under any recognized method of pricing inventory withdrawals, consistently applied. Incoming transportation charges are a proper part of materials and supplies costs.
- c. Only materials and supplies actually used for the performance of a Federal award may be charged as direct costs.
- d. Where federally-donated or furnished materials are used in performing the Federal award, such materials will be used without charge.

27. Meetings and conferences. Costs of meetings and conferences, the primary purpose of which is the dissemination of technical information, are allowable. This includes costs of meals, transportation, rental of facilities, speakers' fees, and other items incidental to such meetings or conferences. But see Attachment B, section 14, Entertainment costs.

28. Memberships, subscriptions, and professional activity costs.

- a. Costs of the governmental unit's memberships in business, technical, and professional organizations are allowable.
- b. Costs of the governmental unit's subscriptions to business, professional, and technical periodicals are allowable.
- c. Costs of membership in civic and community, social organizations are allowable as a direct cost with the approval of the Federal awarding agency.
- d. Costs of membership in organizations substantially engaged in lobbying are unallowable.

29. Patent costs.

- a. The following costs relating to patent and copyright matters are allowable: (i) cost of preparing disclosures, reports, and other documents required by the Federal award and of searching the art to the extent necessary to make such disclosures; (ii) cost of preparing documents and any other patent costs in connection with the filing and prosecution of a United States patent application where title or royalty-free license is required by the Federal Government to be conveyed to the Federal Government; and (iii) general counseling services relating to patent and copyright matters, such as advice on patent and copyright laws, regulations, clauses, and employee agreements (but see Attachment B, sections 32, Professional service costs, and 38, Royalties and other costs for use of patents and copyrights).
- b. The following costs related to patent and copyright matter are unallowable:
 - (i) Cost of preparing disclosures, reports, and other documents and of searching the art to the extent necessary to make disclosures not required by the award

(ii) Costs in connection with filing and prosecuting any foreign patent application, or (ii) any United States patent application, where the Federal award does not require conveying title or a royalty-free license to the Federal Government (but see Attachment B, section 38., Royalties and other costs for use of patents and copyrights).

30. Plant and homeland security costs. Necessary and reasonable expenses incurred for routine and homeland security to protect facilities, personnel, and work products are allowable. Such costs include, but are not limited to, wages and uniforms of personnel engaged in security activities; equipment; barriers; contractual security services; consultants; etc. Capital expenditures for homeland and plant security purposes are subject to section 15., Equipment and other capital expenditures, of this Circular.

31. Pre-award costs. Pre-award costs are those incurred prior to the effective date of the award directly pursuant to the negotiation and in anticipation of the award where such costs are necessary to comply with the proposed delivery schedule or period of performance. Such costs are allowable only to the extent that they would have been allowable if incurred after the date of the award and only with the written approval of the awarding agency.

32. Professional service costs.

a. Costs of professional and consultant services rendered by persons who are members of a particular profession or possess a special skill, and who are not officers or employees of the governmental unit, are allowable, subject to subparagraphs b and c when reasonable in relation to the services rendered and when not contingent upon recovery of the costs from the Federal Government.

In addition, legal and related services are limited under Attachment B, section 10.

b. In determining the allowability of costs in a particular case, no single factor or any special combination of factors is necessarily determinative. However, the following factors are relevant:

- (1) The nature and scope of the service rendered in relation to the service required.
- (2) The necessity of contracting for the service, considering the governmental unit's capability in the particular area.
- (3) The past pattern of such costs, particularly in the years prior to Federal awards.
- (4) The impact of Federal awards on the governmental unit's business (i.e., what new problems have arisen).
- (5) Whether the proportion of Federal work to the governmental unit's total business is such as to influence the governmental unit in favor of incurring the cost, particularly where the services rendered are not of a continuing nature and have little relationship to work under Federal grants and contracts.
- (6) Whether the service can be performed more economically by direct employment rather than contracting.
- (7) The qualifications of the individual or concern rendering the service and the customary fees charged, especially on non-Federal awards.

(8) Adequacy of the contractual agreement for the service (e.g., description of the service, estimate of time required, rate of compensation, and termination provisions).

c. In addition to the factors in subparagraph b, retainer fees to be allowable must be supported by available or rendered evidence of bona fide services available or rendered.

33. Proposal costs. Costs of preparing proposals for potential Federal awards are allowable. Proposal costs should normally be treated as indirect costs and should be allocated to all activities of the governmental unit utilizing the cost allocation plan and indirect cost rate proposal. However, proposal costs may be charged directly to Federal awards with the prior approval of the Federal awarding agency.

34. Publication and printing costs.

a. Publication costs include the costs of printing (including the processes of composition, plate-making, press work, binding, and the end products produced by such processes), distribution, promotion, mailing, and general handling. Publication costs also include page charges in professional publications.

b. If these costs are not identifiable with a particular cost objective, they should be allocated as indirect costs to all benefiting activities of the governmental unit.

c. Page charges for professional journal publications are allowable as a necessary part of research costs where:

(1) The research papers report work supported by the Federal Government; and

(2) The charges are levied impartially on all research papers published by the journal, whether or not by federally-sponsored authors

35. Rearrangement and alteration costs. Costs incurred for ordinary and normal rearrangement and alteration of facilities are allowable. Special arrangements and alterations costs incurred specifically for a Federal award are allowable with the prior approval of the Federal awarding agency.

36. Reconversion costs. Costs incurred in the restoration or rehabilitation of the governmental unit's facilities to approximately the same condition existing immediately prior to commencement of Federal awards, less costs related to normal wear and tear, are allowable.

37. Rental costs of buildings and equipment.

a. Subject to the limitations described in subsections b. through d. of this section, rental costs are allowable to the extent that the rates are reasonable in light of such factors as: rental costs of comparable property, if any; market conditions in the area; alternatives available; and, the type, life expectancy, condition, and value of the property leased. Rental arrangements should be reviewed periodically to determine if circumstances have changed and other options are available.

b. Rental costs under "sale and lease back" arrangements are allowable only up to the amount that would be allowed had the governmental unit continued to own the property. This amount would include expenses such as depreciation or use allowance, maintenance, taxes, and insurance.

c. Rental costs under "less-than-arms-length" leases are allowable only up to the amount (as explained in Attachment B, section 37.b) that would be allowed had title to the property vested in the governmental unit. For this purpose, a less-than-arms-length lease

is one under which one party to the lease agreement is able to control or substantially influence the actions of the other. Such leases include, but are not limited to those between (i) divisions of a governmental unit; (ii) governmental units under common control through common officers, directors, or members; and (iii) a governmental unit and a director, trustee, officer, or key employee of the governmental unit or his immediate family, either directly or through corporations, trusts, or similar arrangements in which they hold a controlling interest. For example, a governmental unit may establish a separate corporation for the sole purpose of owning property and leasing it back to the governmental unit.

d. Rental costs under leases which are required to be treated as capital leases under GAAP are allowable only up to the amount (as explained in subsection b) that would be allowed had the governmental unit purchased the property on the date the lease agreement was executed. The provisions of Financial Accounting Standards Board Statement 13, Accounting for Leases, shall be used to determine whether a lease is a capital lease. Interest costs related to capital leases are allowable to the extent they meet the criteria in Attachment B, section 23. Unallowable costs include amounts paid for profit, management fees, and taxes that would not have been incurred had the governmental unit purchased the facility.

38. Royalties and other costs for the use of patents.

a. Royalties on a patent or copyright or amortization of the cost of acquiring by purchase a copyright, patent, or rights thereto, necessary for the proper performance of the award are allowable unless:

- (1) The Federal Government has a license or the right to free use of the patent or copyright.
- (2) The patent or copyright has been adjudicated to be invalid, or has been administratively determined to be invalid.
- (3) The patent or copyright is considered to be unenforceable.
- (4) The patent or copyright is expired.

b. Special care should be exercised in determining reasonableness where the royalties may have been arrived at as a result of less-than-arm's-length bargaining, e.g.:

- (1) Royalties paid to persons, including corporations, affiliated with the governmental unit.
- (2) Royalties paid to unaffiliated parties, including corporations, under an agreement entered into in contemplation that a Federal award would be made.
- (3) Royalties paid under an agreement entered into after an award is made to a governmental unit.

c. In any case involving a patent or copyright formerly owned by the governmental unit, the amount of royalty allowed should not exceed the cost which would have been allowed had the governmental unit retained title thereto.

39. Selling and marketing. Costs of selling and marketing any products or services of the governmental unit are unallowable (unless allowed under Attachment B, section 1. as allowable public relations costs or under Attachment B, section 33. as allowable proposal costs).

40. Taxes.

a. Taxes that a governmental unit is legally required to pay are allowable, except for self-assessed taxes that disproportionately affect Federal programs or changes in tax policies that disproportionately affect Federal programs. This provision becomes effective for taxes paid during the governmental unit's first fiscal year that begins on or after January 1, 1998, and applies thereafter.

b. Gasoline taxes, motor vehicle fees, and other taxes that are in effect user fees for benefits provided to the Federal Government are allowable.

c. This provision does not restrict the authority of Federal agencies to identify taxes where Federal participation is inappropriate. Where the identification of the amount of unallowable taxes would require an inordinate amount of effort, the cognizant agency may accept a reasonable approximation thereof.

41. Termination costs applicable to sponsored agreements. Termination of awards generally gives rise to the incurrence of costs, or the need for special treatment of costs, which would not have arisen had the Federal award not been terminated. Cost principles covering these items are set forth below. They are to be used in conjunction with the other provisions of this Circular in termination situations.

a. The cost of items reasonably usable on the governmental unit's other work shall not be allowable unless the governmental unit submits evidence that it would not retain such items at cost without sustaining a loss. In deciding whether such items are reasonably usable on other work of the governmental unit, the awarding agency should consider the governmental unit's plans and orders for current and scheduled activity.

Contemporaneous purchases of common items by the governmental unit shall be regarded as evidence that such items are reasonably usable on the governmental unit's other work. Any acceptance of common items as allocable to the terminated portion of the Federal award shall be limited to the extent that the quantities of such items on hand, in transit, and on order are in excess of the reasonable quantitative requirements of other work.

b. If in a particular case, despite all reasonable efforts by the governmental unit, certain costs cannot be discontinued immediately after the effective date of termination, such costs are generally allowable within the limitations set forth in this Circular, except that any such costs continuing after termination due to the negligent or willful failure of the governmental unit to discontinue such costs shall be unallowable.

c. Loss of useful value of special tooling, machinery, and equipment is generally allowable if:

- (1) Such special tooling, special machinery, or equipment is not reasonably capable of use in the other work of the governmental unit,
- (2) The interest of the Federal Government is protected by transfer of title or by other means deemed appropriate by the awarding agency, and
- (3) The loss of useful value for any one terminated Federal award is limited to that portion of the acquisition cost which bears the same ratio to the total acquisition cost as the terminated portion of the Federal award bears to the entire terminated Federal award and other Federal awards for which the special tooling, machinery, or equipment was acquired.

d. Rental costs under unexpired leases are generally allowable where clearly shown to have been reasonably necessary for the performance of the terminated Federal award less the residual value of such leases, if:

(1) the amount of such rental claimed does not exceed the reasonable use value of the property leased for the period of the Federal award and such further period as may be reasonable, and

(2) the governmental unit makes all reasonable efforts to terminate, assign, settle, or otherwise reduce the cost of such lease. There also may be included the cost of alterations of such leased property, provided such alterations were necessary for the performance of the Federal award, and of reasonable restoration required by the provisions of the lease.

e. Settlement expenses including the following are generally allowable:

(1) Accounting, legal, clerical, and similar costs reasonably necessary for:

(a) The preparation and presentation to the awarding agency of settlement claims and supporting data with respect to the terminated portion of the Federal award, unless the termination is for default (see Subpart __.44 of the Grants Management Common Rule implementing OMB Circular A-102); and

(b) The termination and settlement of subawards.

(2) Reasonable costs for the storage, transportation, protection, and disposition of property provided by the Federal Government or acquired or produced for the Federal award, except when grantees or contractors are reimbursed for disposals at a predetermined amount in accordance with Subparts __.31 and __.32 of the Grants Management Common Rule implementing OMB Circular A-102.

f. Claims under subawards, including the allocable portion of claims which are common to the Federal award, and to other work of the governmental unit are generally allowable. An appropriate share of the governmental unit's indirect expense may be allocated to the amount of settlements with subcontractors and/or subgrantees, provided that the amount allocated is otherwise consistent with the basic guidelines contained in Attachment A. The indirect expense so allocated shall exclude the same and similar costs claimed directly or indirectly as settlement expenses.

42. Training costs. The cost of training provided for employee development is allowable.

43. Travel costs.

a. General. Travel costs are the expenses for transportation, lodging, subsistence, and related items incurred by employees who are in travel status on official business of the governmental unit. Such costs may be charged on an actual cost basis, on a per diem or mileage basis in lieu of actual costs incurred, or on a combination of the two, provided the method used is applied to an entire trip and not to selected days of the trip, and results in charges consistent with those normally allowed in like circumstances in the governmental unit's non-federally-sponsored activities. Notwithstanding the provisions of Attachment B, section 19, General government expenses, travel costs of officials covered by that section are allowable with the prior approval of an awarding agency when they are specifically related to Federal awards.

b. Lodging and subsistence. Costs incurred by employees and officers for travel, including costs of lodging, other subsistence, and incidental expenses, shall be considered reasonable and allowable only to the extent such costs do not exceed charges normally allowed by the governmental unit in its regular operations as the result of the

governmental unit's written travel policy. In the absence of an acceptable, written governmental unit policy regarding travel costs, the rates and amounts established under subchapter I of Chapter 57, Title 5, United States Code ("Travel and Subsistence Expenses; Mileage Allowances"), or by the Administrator of General Services, or by the President (or his or her designee) pursuant to any provisions of such subchapter shall apply to travel under Federal awards (48 CFR 31.205-46(a)).

c. Commercial air travel.

(1) Airfare costs in excess of the customary standard commercial airfare (coach or equivalent), Federal Government contract airfare (where authorized and available), or the lowest commercial discount airfare are unallowable except when such accommodations would:

- (a) require circuitous routing;
 - (b) require travel during unreasonable hours;
 - (c) excessively prolong travel;
 - (d) result in additional costs that would offset the transportation savings; or
 - (e) offer accommodations not reasonably adequate for the traveler's medical needs.
- The governmental unit must justify and document these conditions on a case-by-case basis in order for the use of first-class airfare to be allowable in such cases.

(2) Unless a pattern of avoidance is detected, the Federal Government will generally not question a governmental unit's determinations that customary standard airfare or other discount airfare is unavailable for specific trips if the governmental unit can demonstrate either of the following: (a) that such airfare was not available in the specific case; or (b) that it is the governmental unit's overall practice to make routine use of such airfare.

d. Air travel by other than commercial carrier. Costs of travel by governmental unit-owned, -leased, or -chartered aircraft include the cost of lease, charter, operation (including personnel costs), maintenance, depreciation, insurance, and other related costs. The portion of such costs that exceeds the cost of allowable commercial air travel, as provided for in subsection c., is unallowable.

e. Foreign travel. Direct charges for foreign travel costs are allowable only when the travel has received prior approval of the awarding agency. Each separate foreign trip must receive such approval. For purposes of this provision, "foreign travel" includes any travel outside Canada, Mexico, the United States, and any United States territories and possessions. However, the term "foreign travel" for a governmental unit located in a foreign country means travel outside that country.

We suggest that the purposes of the MCCA be explicitly broadened to include non-lobbying/political activities to attract support from a broader range of members.

Article III, Purposes, Section 3.1:

(a) working with the Maine State legislature to highlight the importance of cultural resources in Maine, such as museums, libraries, historic preservation, the arts and humanities;

(b) publicizing the work, accomplishments, and contributions to the community of these organizations; and

(c) lobbying for increased funding for the same; and

(b) engaging in any and all lawful activities incidental to and in pursuit of the foregoing purposes, except as restricted herein.

Suggested membership dues structure:

Membership of the Alliance will be drawn from statewide associations, cultural institutions and businesses, and individuals.

Recognition	Organizations		Individual
	Association	Institution	Memberships
Member	\$100 - \$500	\$50 - \$500	\$25 - 100
Supporter	\$501 - \$1,000	\$501 - \$1,000	\$101 - 250
Patron	\$1,001 - \$5,000	\$1,001 - \$5,000	\$251 - 1,000
Benefactor	\$5,001 or more	5,001 or more	\$1,001 - or more

July 14, 2005

J.R. Phillips and Jim Henderson

Code of Ethics

DRAFT #1

Preamble

This Code of Ethics for the staff of the Maine Cultural Affairs Council establishes standards for professional conduct. It introduces new members to those standards, reminds us of our professional responsibilities, and serves as a model for the Council's policies. It is also intended to inspire public confidence in the Council. This code provides an ethical framework to guide its members, but does not provide solutions to specific problems.

I. Purpose

The Council recognizes the importance of educating ourselves, our staff, and the general public by codifying ethical principles to guide our work.. This code provides a set of principles to which we aspire.

II. Professional Relationships

The Council is created to ensure a coordinated, integrated system of cultural resources programs and projects and shall ensure the support of cultural heritage institutions and activities of the State. A major component of its mission is to administer the Communities in the New Century Program, including making expenditures and providing grants to meet the goals of an integrated system of programs and policies. The Council cooperates with other similar institutions to advance this goal. Respect, courtesy, responsiveness, and cooperation form the basis of all professional relationships with colleagues, and with institutions seeking and receiving assistance from the Council.

III. Judgment

The Council should exercise professional judgment in its deliberations and actions, and not allow personal, non-professional biases to affect its decisions.

IV. Trust

The Council members should not profit or otherwise benefit from privileged access to, and control of, information under their authority or control. Members should avoid any interest or activity that is in conflict with the conduct of official duties.

V. Integrity

The Council strives to preserve and protect the integrity of its procedures, and those of member institutions engaged in grant administration funded by the Council by providing open access to its deliberations and records.

VI. Access

The Council provides open and equitable access to its services and records without discrimination or preferential treatment, and in accordance with legal requirements, cultural sensitivities, and institutional policies.

*Revised
10/25/07*

Concerns about the Conduct of the Internal Audit
Regarding the Maine Community Cultural Alliance

October 24, 2007

We are entering into the record our opinion that the integrity of the internal audit review was compromised by the conduct and process of investigation.

Months prior to the initiation of the Internal Audit Review, the State Archivist informed support personnel at the State Library that a "forensic audit" was being ordered by the Commissioner of Finance and Administration, specifically directed toward certain cultural agencies. It is important to note that this information paralleled a legislative proposal to re-organize the cultural agencies under the Secretary of State.

Our direct participation began on September 7, 2007 with a review of "preliminary findings" that had already been presented by the auditor to the Commissioner of Finance and Administration. Prior to this review, no formal notification of the audit was given to the directors of the cultural agencies. No copies of documents that formed the opinion were given to the directors. There was no explanation or orientation as to the conduct of the investigation, rules of confidentiality, or guidelines to protect the agencies from speculation and harm while undergoing an investigation. Without these guidelines, the agencies were compromised and seriously exposed to speculative innuendo and harm. This was especially true of the Maine Humanities Council and Maine Historical Society, who depend on goodwill, reputation, and community support for programs and budget.

On September 12, 2007 and immediately after the auditor's review of travel expenditures with business staff at the Maine State Library, the auditor and the State Archivist were overheard in the public bench area outside of the entrance to the Cross Building. Their conversation, clearly audible to the public, involved a discussion of travel, names of two directors, and concluded by the Archivist's remark, "...then they're fried!" (State Library Director and Arts Director), a not too subtle revelation of malicious intent, reckless behavior, and breach of confidentiality.

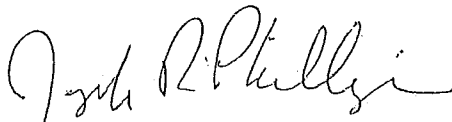
On September 14, 2007, the Director of the Humanities Council called the State Librarian with concerns for the integrity of his institution. The State Archivist had told the former chancellor of the University of Maine, also a board member of the Maine Humanities Council, that the "Cultural Affairs Council was about to blow-up", and would do harm to the Humanities Council. In our opinion, this was a breach of confidentiality and unethical conduct.

On September 19, 2007, a State Library business office staff member was invited to have a conversation with the State Archivist and the Secretary of State. The subject was finding a new job opportunity for this person within the offices of the Secretary. This conversation included details of restructuring the cultural agencies, possible Office of Program Evaluation and Government Accountability (OPEGA) reviews, and the remark by the Secretary that "The boys (cultural directors) are in more trouble than they

could ever imagine." The State Library employee also was made aware of conversations in the Controller's Office and Motor Vehicles office about the future of positions engaged in administering the business functions for the cultural agencies at the Maine State Library. These conversations were related to the audit process.

This incident was an unethical and gross intrusion by the Secretary and the State Archivist into the work-force and well-being of agency operations, in this case the Maine State Library. It was alarming, stressful and de-moralizing to staff.

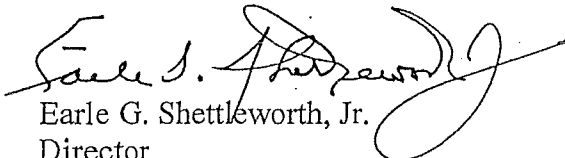
In summary, we believe that the audit process was seriously flawed and poorly managed. We regret that the Controller's letter of October 15th, advising strict confidentiality at the end of the audit process was not there at the beginning. The lack of confidentiality and breaches in ethical behavior by the participants who brought these charges, leads us to the conclusion that the audit lacked integrity and therefore credibility.



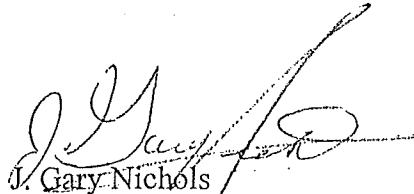
Joseph R. Phillips
Director, Maine State Museum



Alden C. Wilson
Director, Maine Arts Commission



Earle G. Shettleworth, Jr.
Director
Maine Historic Preservation Commission
Maine State Historian



J. Gary Nichols
Director, Maine State Library
State Librarian

Maine State Cultural Affairs Council
c/o Maine State Library
64 State House Station
Augusta, Maine
04333-0064

October 24, 2007

Edward A. Karass
State Controller
14 State House Station
Augusta, Maine 04333-0014

Dear Mr. Karass:

We appreciate having had the opportunity to review the draft audit report. You will find our comments attached.


Also attached, you will find additional comments on the internal audit review process. At this point, we recommend that the report be tabled, and the parties involved be convened to resolve issues constructively and amicably. This is one of those junctures where those in governmental authority can provide leadership on behalf of the citizens they represent, or follow a path of continued contentiousness and negativity which is a disservice to the State of Maine. The Cultural Agency Directors would appreciate the opportunity to meet with the DAFS Commissioner about the audit and to offer our willingness to work constructively on these matters in the future.

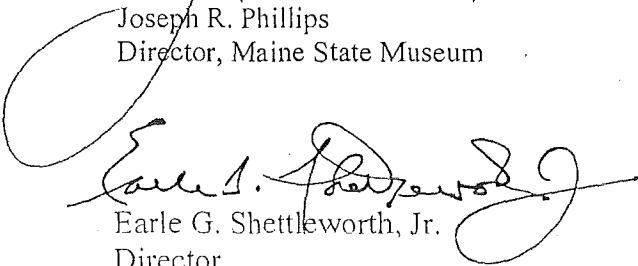
Enclosures:

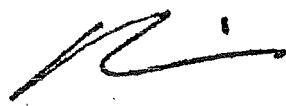
(1) Response to Draft Internal Audit Review of the "State of Maine's Relationship to the Maine Community Cultural Alliance and Verrill Dana, LCC," dated October 2007

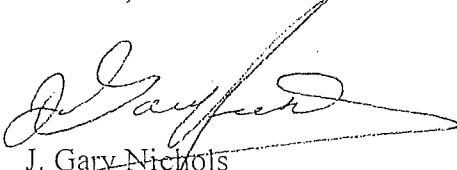
(2) Concerns about the Conduct of the Internal Audit Regarding the Maine Community Cultural Alliance, dated October 24, 2007

Sincerely,


Joseph R. Phillips
Director, Maine State Museum


Earle G. Shettleworth, Jr.
Director
Maine Historic Preservation Commission
Maine State Historian


Alden C. Wilson
Director, Maine Arts Commission


J. Gary Nichols
Director, Maine State Library
State Librarian

Response to Internal Audit Review of the State of Maine's Relationship to the Maine Community Cultural Alliance and Verrill and Dana, LLC

October 24, 2007

The Internal Audit Review focuses on the alleged use of state funds for lobbying. None of the State funds distributed by the state cultural agencies to the Maine Community Cultural Alliance (MCCA), were used for lobbying as verified by Verrill Dana, LLC. As stated in the Internal Audit Review "...the Office of the State Controller does not draw any conclusions regarding this issue."

MCCA payments to Verrill Dana were properly used for activities such as: defining cultural goals and integrating those with economic objectives; building coalition partnerships; advising on integrating New Century Community Program planning with community development initiatives, and other non-lobbying activities. There has been no unethical conduct by any of the cultural agencies. The substance of this report questions no more than a few thousand dollars of expenditures over a three year period by four highly respected agencies.

After careful review and analysis we submit the following comments and requested changes.

Background and scope

- We object to the tone of this paragraph. It is not objective and contains prejudicial language.
- We request that the sentence starting with "Our initial work..." be removed as the findings do not support this statement.

Maine Cultural Affairs Council (CAC)

- We recommend including this subheading and the following language to clarify the nature of the Cultural Affairs Council in contrast with that of the Maine Community Cultural Alliance: The Maine Cultural Affairs Council consists of a chair of the Cultural Affairs Council (appointed by the Governor), the chairs and vice-chairs of the Maine Arts Commission, Maine Historical Preservation Commission, Maine Library Commission, Maine State Museum Commission, Maine State Archives Advisory Board, Maine Humanities Council, and Maine Historical Society. Non-voting members consist of the directors of the seven cultural agencies and the governor's liaison.

The Maine Community Cultural Alliance (MCCA)

- The first sentence should not contain the word “wrongdoing”. This immediately sets a prejudicial tone. In actuality the audit does not draw any conclusions regarding inappropriate lobbying by the Cultural Affairs Council.
- The CAC has not yet been given copies of the evidence that prompted this internal audit review.
- Line three refers to a charter for the MCCA. There is no charter. There are by laws. (See **Attachment 1**) and Articles of Incorporation (see **Attachment 2**).
- The unsigned letter of agreement represents a draft proposal presented by Verrill and Dana. The Directors of the Cultural Agencies were not board members of MCCA. Therefore, to the best of our knowledge, the activities and services provided by Verrill and Dana were as follows: building coalition partnerships; advising on outreach to communities; helping to identify people who care about culture and cultural programming; helping to define cultural goals and integrating those with economic objectives; assisting in articulating cultural ideals into community needs; advising on coordinating cultural projects and planning to compliment executive priorities such as Pine Tree Economic Development Zones, Creative Economy initiatives, downtown revitalizations and Washington County Development Projects; strategic advice on bonding – what can and cannot fit under State bonding; advising on integrating New Century planning with community development initiatives; drafting planning documents and cultural policy; arranging meetings with coalition partners; attending numerous meetings for general advice and counsel; reviewing information drafts and grants processes; presenting at and participation in workshops about the Cultural Affairs Council at state and national functions; advising on trends in government policy; participating in telephone conferences, e-mails, and memos; and advising on long-range cultural planning.

History and Context

- The CAC is an organization of the seven state-related cultural agencies as specifically cited in law. Its purpose was not to include every for-profit or non-profit cultural organization in Maine as implied in the language in this section. The MCCA had a legitimate role different from the CAC. The MCCA represented all non-profit and for-profit cultural groups in Maine and had a much broader mission than the one defined in law for the CAC.
- The CAC serves as a primary forum for interagency cooperation and planning. The CAC structure improves communications, enhances coordination of work, and facilitates planning and administration for each of the participating agencies. In 2002 the CAC received recognition from the Harvard-Kennedy School/Ford Foundation Innovations in American Government Award program as one of the nations’ most innovative government programs.
- This section is confusing. It implies that the CAC took over from the MCCA when in fact the two worked in parallel. The CAC started in 1990 when legislative authorization took place.

- The phrase describing the CAC “with responsibility for convening and coordinating the activities of the different cultural groups in the state” is incorrect. It should be removed.
- In the second paragraph under the heading History and Context, delete the word “certain” before members. The connotation is misleading. The Cultural Affairs Council always works as a body. During 2004 the Cultural Affairs Council entered into discussions with Verrill Dana. We therefore request substituting “began discussions with” for “became involved with.” We wish to point out that the reference “cultural agency agenda” refers to a specific action plan of objectives to improve the cultural economy of the State of Maine. The last two sentences of this paragraph are based on conjecture and therefore are irrelevant.
- In the third paragraph’s first sentence please omit “Directors” and “others”. For accuracy this section should read “Meetings took place among Verrill Dana LLC, the CAC, and leaders of community cultural organizations. These leaders included representatives from the University, public libraries, and other interested individuals.
- In the third paragraph’s second sentence please replace “driven” with “organized” and “directors of the several cultural agencies” with “CAC members”.
- In the fourth paragraph beginning with “Control of the organizations finances...” and in reference to “We have been unable to locate any official roster of board members or any meeting minutes”, these files and activities were responsibilities assigned to the CAC Coordinator employed by the Maine State Library for this purpose.
- Items 1-5 in this section were written by the CAC Coordinator. Why are these relevant to the audit report? These five items are legal, appropriate and ethical.
- Sixth paragraph – Why is the information in this paragraph relevant to the report? We request deleting this text.
- Seventh paragraph – Line 7 ...“we argue that the Maine Arts Commission and the Maine State Museum contributed state funds to the MCCA with the knowledge that these funds would be directly used to pay for costs incurred by the MCCA for Verrill and Dana’s Services.” A small amount of state, federal and private funding was used to pay for consulting fees and costs related to the legal establishment of the MCCA, but certainly not any lobbying activities. The CAC understood, and was sensitive to the fact that state funds should not be used to support lobbying. Verrill and Dana has made an enormous commitment of pro bono services to the state and its cultural community. We note that the report questions no more than a few thousand dollars over several years by four government agencies. Place this in the context of millions of dollars in their state budgets and several million more in federal sources of revenue during the same time period. The agencies have met required reporting, adhered to lobbying rules, and participated in appropriate collaborative activities. The conduct of the agency directors has always been honorable; their behavior is such that each has been recognized for outstanding achievement and leadership at federal, state and local levels.

- Regarding OMB A-87 please see Attachment 3 Section 28 (membership, subscriptions and professional activity costs) and Section 32 (professional services cost). These sections will clarify that federal money can be used for membership in business, technical, professional, civic, community, and social organizations.
- Seventh paragraph – The disposition of MCCA funds after its closure is questioned. This money was put in the CAC account until the matter of its final disposition could be determined.
- The entire **Exhibit A** should be omitted. It is confusing and misleading. It is full of innuendos and misinformation as demonstrated by the following examples:
 - The title “Maine Cultural Agencies Process to Fund and Conduct Lobbying Activities” is misleading. There were no paid lobbying activities by state agencies. The audit report states: “The office of the State Controller draws no conclusions regarding this issue.”
 - The boxes below the title, “Maine Library Association and Verrill and Dana LLC” have no relationship to the Cultural Agencies and should be omitted.
 - The seven boxes listing the names of Maine’s cultural agencies are all linked to the Maine Community Cultural Alliance box indicating lobbying activity. This is not the case as agency documentation verifies. The text in these boxes should be removed. It seems to suggest an impropriety which does not exist.
 - The box on the right addressing the \$3,000 paid into the Alliance by the Maine Humanities Council and Maine Historical Society and its return, has no relevancy. We request its removal.
 - The box on the right referencing Portland Public Library Director should not contain the name of a specific individual. The text makes an unfair inference by connecting money received from the State to the MCCA. Documentation exists to verify that expenditures made to PPL were legal and appropriate.
 - The reference to the \$2,500 paid to Verrill and Dana on Jan. 26, 2007 was not for lobbying.
 - The payment source “unknown” box on the lower left of this exhibit is confusing. We recommend that the source of this funding be confirmed with Verrill and Dana.
 - Regarding the Maine Library Association, this association had a separate contractual agreement with Verrill and Dana. MLA’s agreement had nothing to do with the MCCA. It has no relationship to Exhibit A and should be removed.

- Regarding the \$10,000 received from the State of Maine by the nonprofit organization, Maine Preservation, these funds represent \$7,500 in federal funds for a newsletter and \$2,500 for an annual conference. The \$3,000 cited in the chart was a gift to Maine Preservation from a private citizen.
- **Exhibit B** -We can not comment on this exhibit because records of the transactions are in the hands of the former CAC Coordinator who was also Treasurer of the MCCA. They are not in our possession although we asked for return of the check register in the spring of 2007 so the account could be reconciled.
- Paragraph 8 – In reference to the Verrill Dana bill of \$51, 98.77, this finding is unmerited because Verrill and Dana submitted this invoice to substantiate pro bono work. The sentence that follows is speculative and editorial in context and should be removed.
- In regard to the tangible work products provided by Verrill and Dana, we refer you to the Verrill and Dana responses dated Sept 25, 2007 and Oct. 3, 2007 for the list of tangible work products.
- Paragraph 8 – Again we refer you to the Verrill and Dana responses of Sept 25 and Oct. 3, 2007.
- Paragraph 11 – Regarding the phrase, “we assert that is likely”, we disagree with this assertion on the basis that all four agencies fund and participate in nonprofit organizations to advance the goals of their respective fields. For example, federal regulations allow the Maine Historic Preservation Commission to pay dues and participate in the National Conference of State Historical Preservation Officers whose activities include congressional and executive branch advocacy for national historical preservation activities. The Maine State Library is an institutional member of the American Library Association whose primary goal is to support for libraries nation-wide. For 35 years the Maine State Museum has been an active institutional member of the American Association of Museums, which is the national accreditation authority and which speaks for the American Museum community. The Maine Arts Commission has a membership in the National Association of State Arts Agencies which advocates for cultural issues nation-wide. Many other examples of appropriate, long-term, non-profit organizational memberships can be provided from nearly every entity of State government.
- Sentence two – That “a dummy corporation was created as a pass through mechanism” should be removed because it is a speculative premise and editorial comment. The council never decided this. The efforts to reconstitute the MCCA were based upon the model of the previous independent organization of that name with its broad based goals and representatives.

Findings

- **Internal Control over Financial Administration**

We disagree with this finding. The financial operations conducted by the business office of the cultural agencies are in accordance with state and federal procedures.

It is our experience that those employees who have directed the cultural agencies' business office have conducted their work in such a professional manner as to ensure the independence of their judgments as required by their job classifications.

- **Misuse of State Funds** (Please change title to **Use of State Funds**.)

We object to the characterization of this finding as misuse of state funds. There is no basis to substantiate this claim; thus this heading is misleading.

- Dues paid to the MCCA are appropriate expenditures.
- Regarding the last line on page three, there is a budget line (4900 series) which included the object code for dues. (See **Attachment 4** for MCCA dues structure.)

Regarding the paragraph that begins with "a review of Maine law...As agency directors of long-standing we are fully aware of the annual requirement under Section 316-A to register for lobbying purposes. Several of the directors interpret their roles before the legislature as including this activity and have registered as such. Therefore, we see no reason for this finding.

- **Non Compliance with Title 27 Section 557**

- During the first several years of the CAC, the Council filed a separately published annual report of its activities with the Governor and the legislature; however, in response to increasing budget constraints by the State of Maine the Council has chosen to use the vehicle of the Maine State Government Annual report to fulfill this statutory requirement. This section should be removed.

- **Exceeding Legislatively Authorized Authority**

- None of these bullets rise to the level of the heading "Exceeding Legislatively Authorized Authority". These appear to be administrative recommendations and not findings of "exceeding legislatively authorized authority".
- The first bullet under this heading is highly subjective and judgmental and does not belong in an audit report. This bullet has nothing to do with "exceeding legislatively authorized authority".
- The "common setting" referred to was the Directors' first official briefing by the auditor concerning the fact that their agencies were receiving an internal control audit. At the outset of this briefing the auditor read a lengthy statement summarizing his perceptions of his findings to date. This statement included several accusatory and inflammatory words that left the Directors highly uncertain about the scope and purpose of the audit process. Based upon this experience, the directors believed that they needed to proceed carefully and thoroughly in researching the events that had occurred several years ago. This should not be characterized as "less than forthcoming".

- Regarding the second bullet which starts with “The directors on behalf of the CAC should have consulted with the office of the Attorney General...”, we respond that in the case of administering our agencies we frequently consult with the Attorney General’s Office on a variety of issues. We did not believe that there was any impropriety whatsoever, thus did not consult with the Attorney General’s Office. However, in the future we will bring such issues forward to the appropriate staff in the Attorney General’s office.

- Third bullet – “The Directors should have been more active and forthcoming in requesting budgetary assistance from the Commission of DAFS...” The MCCA was not established by the Cultural Agencies as a flow through mechanism. Therefore, we did not perceive this as an issue to bring to the attention of the Commissioner. However, in the future we will bring such issues forward to the Commissioner’s office.

- In reference to the sentence beginning “The CAC and the agencies represented by the Council..” it is common practice throughout state government for departments and independent agencies to form cooperative alliances with non-profit organizations comprised of citizens from the private sector who share goals for the benefit of the State and its citizens. We should not be asked to refrain from this common practice in the future. However, if there are procedural questions regarding these matters, we will review them with the Attorney General.

Conclusion

We disagree with the conclusion in that the effort to revive the MCCA did have a well defined and well intended purpose. However, the execution of reviving the MCCA was poorly managed by the person responsible for its implementation, the CAC Coordinator. During part of the events in question, he was an employee of the CAC, and we take responsibility for his actions.

Recommendations

- 1st bullet - While we certainly agree with the first recommendation, we fail to see how it applies. No procurement processes were violated nor were contracts signed.
- 2nd bullet – These funds were deposited to the Cultural Affairs Council not the New Century Library Program. The funds are held in a special revenue account of the Cultural Affairs Council until there is further clarification on where the funds should be returned. Regarding OMB Circular A-87 please see our previous comment.
- 3rd bullet – We appreciate the constructive nature of this recommendation for the Cultural Agencies and look forward to entering into discussions with the Commissioner of DAFS as to how this may be successfully implemented.
- 4th bullet – The Directors of the four cultural agencies are all longstanding career public employees with more than a century and a quarter of honorable combined service to the State of Maine. Even suggesting that there was some sort of ethical

lapse is at best in poor taste and at worst an insult. While always willing to review rules of ethics, as that is what careful people in positions of responsibility do, the suggestion in the context of this case is nothing short of patronizing. We have reviewed the code of ethics accepted by the CAC (See Attachment 5) and maintain the issue of ethics should not be linked to this audit report.

- 5th bullet – We agree with this recommendation with the exception of the last ten words of the sentence which falsely asserts a “breach of ethics”. This is not the case, and we request that these words be deleted.
- Attachment 6 addresses our concerns about the conduct of the audit report.

Exhibit A – See Comments on page 4

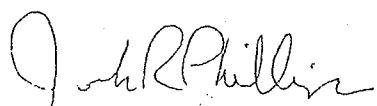
Exhibit B – See Comments on page 5

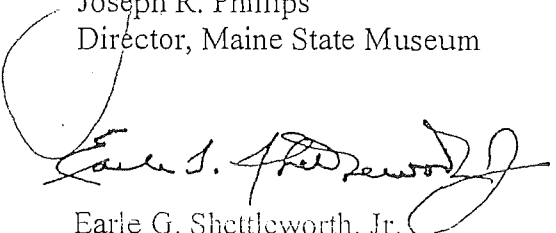
Response Summary


In summation, there has been no unethical conduct by any of our agencies. The substance of this report questions no more than a few thousand dollars of expenditures over a several year period by four government agencies. The Internal Audit Review draft presents specious arguments regarding the development and function of the MCCA whose sole purpose was to promote the cultural interests of the State. Again, no state funds were expended for lobbying.

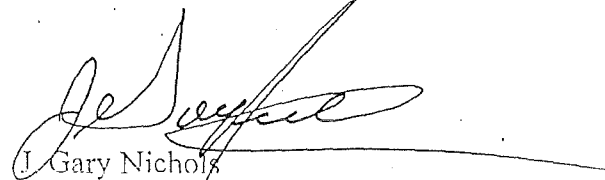
The agencies have met required reporting, adhered to lobbying rules, and participated in appropriate collaborative activities. The conduct of the agency directors has always been honorable; their behavior is such that each has been recognized for outstanding achievement and leadership at federal, state and local levels.

These cultural agencies are more than willing to work constructively with the Department of Administrative and Financial Affairs to bring this matter to a productive conclusion for all parties concerned.


Joseph R. Phillips
Director, Maine State Museum


Earle G. Shettleworth, Jr.
Director
Maine Historic Preservation Commission
Maine State Historian


Alden C. Wilson
Director, Maine Arts Commission


J. Gary Nichols
Director, Maine State Library
State Librarian