Calculation of Indirect Costs: Frequently Asked Questions

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First, some background

Total Cost of Federal Awards

Direct 90%
Indirect 10%

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Costing Options:
1. Direct Charge
2. Cost Allocation Plan (CAP)
3. Indirect Costs/Facilities and Administrative (F&A) Costs

What Is The Purpose Of The Indirect Cost Rate?
- Allows agency to recover some costs incurred to run federal programs that are otherwise too integrated to identify
- Take portion of grant as “recovery”; treat as non-federal funding.
- Creates tension in agency because reallocates funds from the program

How To Get An Indirect Cost Rate?
- Non-federal entities apply to “cognizant agency”
- Unless specified by OMB, generally the “cognizant agency” is the federal agency with the preponderance of direct funding
- “Cognizant agency” authority may be delegated to nonfederal agencies
  - For example, SEAs have methodology approved through “delegation authority” from ED. LEAs must apply to SEA.
  - Post-secondary and nonprofit subgrantees receive “restricted” rates from the SEA.
Submission of Indirect Cost Rate Proposals

1. Organization Chart
2. Cost Policy Statement
3. Financial Reports
4. Personnel Cost Worksheet And Allocation, Direct Versus Indirect
5. Statement of Employee Benefits

Continued…

6. Indirect Cost Rate Proposal(s) reconciled with the financial report of budget. Total Costs Concept.
7. A completed Certificate of Indirect Costs
8. Support Schedules (equipment, depreciation, terminal leave payments, subawards)
9. Listing of grants and contracts

FAQ 1: Can I charge ________ as an indirect cost?

Classifying costs as direct vs. indirect.
There is no universal rule for classifying certain costs as either direct or indirect.

2 CFR 200.412

But...there are guidelines

What are Direct Costs?

Costs that can be identified specifically with a particular final cost objective.

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

EX: Compensation of employees for effort on the performance of the award; materials and equipment; travel expenses

What are Indirect Costs?

Costs incurred for common or joint purposes.

Cost cannot be readily and specifically identified with a particular cost objective without effort disproportionate to the results achieved.

EX: Accounting; Human Resources; Payroll; Legal Division; Utilities

2 CFR 200.56
What are Indirect Costs?

- "Administration" is defined as general administration and general expenses such as the director’s office, accounting, personnel, and all other types of expenditures not listed specifically in “Facilities”
  - Nonprofits – includes library expenses
  - IHEs – library expenses included in “Facilities”
- “Facilities” is defined as depreciation on buildings, equipment and capital improvement, interest on debt associated with certain buildings, equipment and capital improvements, and operations and maintenance expenses
  - Appendix III, B. 1.

Selected Items of Cost – Classification as Indirect Costs

- Advisory Council allowed only if authorized by statute OR as an indirect cost where allocable to federal awards, 200.422
- Bonding costs required in the general conduct of operations, 200.427(c)
- Commencement and convocation costs allowable only as indirect student activity costs
- Unused leave payments must be charged indirectly, 200.431(b)(3)(i)*
- Proposal costs should normally be treated as indirect costs (may be charged directly only with prior approval by federal agency), 200.460
- Rearrangement and reconversion of facilities are allowable as indirect costs, 200.462

Wait...there's more

- For programs with supplement not supplant provision, must use a Restricted Rate
- Under restricted rates, indirect costs are defined as:
  - General Management Costs: activities for the direction and control of the grantee’s affairs that are organization-wide
  - Excluding:
    - Divisional administration limited to one component of grantee
    - Governing body of the grantee
    - Compensation of the chief executive officer of the grantee
    - Compensation of the chief executive officer of any component of the grantee; and
    - Operation of the immediate offices of these officers
      - EDGAR 76.565
Two prong definition:
- (1) Organization-wide
- (2) Direction and control of the organization

For example…
- Grant writers, even if considered “proposal costs” (must proportionately support both federal and non-federal activities within the agency)
- Curriculum development, pupil data, library services, evaluation services, and school services (although cross-cutting, not for the “direction and control of the organization” – rather provide services to schools or students)

What are “component” costs?
- Generally, organizational units “one management level below the executive office”
- Component heads and their direct reports are adjusted
  - Org chart is key!

Sometimes costs incurred for common or joint purposes and that cannot be identified with a specific cost objective (meeting the UGG definition of “indirect”), could not be classified as indirect costs under a restricted rate (fail to meet “general management” definition).
FAQ 2: When (and why) do I have to exclude contract costs over $25k?

Applying the indirect cost rate.

Charging Indirect Costs to Federal Awards

- Calculation: It’s a fraction!!
- Top: “Indirect Cost Pool”
- Bottom: “The Base”
  - Can be “Total modified direct cost base” or “Salaries and Wages”, etc.

Top: Indirect Cost Pool

- EX: Accounting; Personnel; Legal; Utilities
- All employees must be paid with non-federal funds (even though giving some benefit to federal programs)
- Would not keep time distribution records (as long as not split between indirect and direct)
Bottom: “Modified Total Direct Cost Base”

- All direct costs (All federal and non-federal expenses)
- Must show benefit to federal program
- Minus “distorting items”

Applying the Rate

- Apply rate (percentage) to the base (apply to your current year direct costs minus capital expenditures, etc., NOT entire grant!)
- That “reimbursement” has no federal accountability

Wrong Way/Right Way:
Modified Total Direct Cost Base (MTDC)

<table>
<thead>
<tr>
<th>Incorrect Calculation</th>
<th>Correct Calculation</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total Award</strong></td>
<td><strong>Total Direct Costs</strong></td>
</tr>
<tr>
<td>$4,000,000</td>
<td>$3,350,000</td>
</tr>
<tr>
<td><strong>Less: Equipment</strong></td>
<td><strong>Less: Subcontract</strong>:</td>
</tr>
<tr>
<td>($100,000)</td>
<td>($2,550,000)</td>
</tr>
<tr>
<td><strong>Plus: first $25,000</strong></td>
<td><strong>MTDC Base</strong></td>
</tr>
<tr>
<td>$0</td>
<td>$750,000</td>
</tr>
</tbody>
</table>

- Rate Applied: 20%
- Indirect costs: $800,000
- Rate Applied: 20%
- Indirect costs: $150,000
Applying the Rate - Frequency

- Can claim indirect costs periodically (monthly, quarterly, annually)
- Must be based on actual expense already incurred (i.e., couldn’t take all at beginning of year)

Exclusions from MTDC Base (200.68)

- Equipment
- Capital Expenditures
- Charges for patient care
- Rental costs
- Tuition remission
- Scholarships and fellowships
- Participant Support Costs
- Subawards in excess of $25,000
- Other items with approval of cognizant agency for IC

Definition of “subaward” (200.92)

- An award provided by a pass-through entity to a subrecipient. “It does not include payments to a contractor…”
What ED says…

- “When we talk about subawards, we are talking about subgrants and subcontracts. … We have to look at it on a case-by-case basis.”
- Whether the portion over $25k will be excluded “depends upon the amount of administrative handling involved in that subaward or subgrant.”
- ED links to DOL’s guide:
  - As a general rule … only the first $25,000 of each subcontract, subgrant and professional service agreement should be included in the distribution base. This recognizes that grantees/contractors expend a minimal amount of indirect costs on subcontracts.

Cost Allocation Guide

- Subawards
  - Grantee hires individual to perform speech pathology services to students in school, is this a “subaward”?
    - No, although professional service, this auxiliary expertise is normally provided in-house
  - Grantee contracts with software vendor to provide technical support and enhancement of existing business software, is this a “subaward”?
    - No, organization-wide support, this is an indirect cost
  - Grantee hires school nurse that provides medication (not an instructor) to students in class, is this a “subaward”?
    - No, although professional service, this auxiliary expertise is normally provided in-house

English Please!

- Federal agencies, including ED, have interpreted “subawards” broadly to include certain professional service agreements as distorting items that must be excluded. Therefore, whether the amounts above $25,000 under certain contracts must be excluded from the calculation and recovery of indirect costs will depend on your approved rate, as negotiated with the awarding agency.
- What about multi-year subawards/contracts?
  - May apply the $25,000 each year.
FAQ 3: If admin is capped at 5%, must my ICR also be capped at 5%?

The relationship between indirect and admin.

Administration vs. Indirect

Administrative costs may be direct OR indirect

Administrative Cost Cap

- Limit applies against total grant amount
- Grantee should list administrative costs in budget breakout

All costs of administrative activities count towards the administrative cost cap

- Must review Indirect Cost pool and identify which costs meet program definition of administrative
- Admin cap will NOT limit indirect costs associated with programmatic / non-administrative costs!!!
For example:
- Grantee’s Indirect Cost Rate is 10%
- The majority of the indirect costs (80%) are “administrative”, the rest of the indirect costs (20%) are “programmatic.”
- “ED generally considers all indirect costs to be administrative for states and local districts
- Grant A = $100,000
- The admin cap is 7.5%, or $7,500
- Grantee Expenditures:
  - Direct program expenditures: $90,000
  - Direct admin expenditures: $2,500

For example (cont.):
- Applying Indirect Cost Rate:
  - Total direct expenditures: $92,500
    - (Minus Distorting items)
      - Equipment ($10,000)
      - Subaward ($42,000)
      - Plus first $25k of subaward $25,000
    - Modified Total Direct Costs: $65,500
  - Indirect Costs:
    - $65,500 * 10% = $6,550

For example (cont.):
- Grant A:
  - Direct program expenditures: $90,000
  - Direct admin expenditures: $2,500
  - Indirect admin costs:
    - $6,550 * 80% = $5,240
    - **But admin cap is $7,500, therefore can only recover $5,000 in indirect admin costs:** $5,000
  - Indirect program costs:
    - $6,550 * 20% = $1,310
    - Total Expenditures: $98,810
A simpler example:

- Perkins subgrant has 5% cap on admin
- Post-secondary subgrantee has 8% restricted rate
- Perkins subgrant = $100,000
- Grantee spent entire award
  - $50,000 went toward equipment, distorting items
- Applying the rate: $50,000 * 8% = $4,000
- Even if all indirect costs are “administrative”, grantee still does not exceed 5% cap in applying 8% rate.

So the answer is...?

- Not necessarily. If admin is capped at 5%, the grantee may still apply a higher indirect cost rate. However, recovery of indirect administrative costs and direct administrative costs must be within the 5% cap.

One more thing before we move on...

NEW: Direct v. Indirect Costs Administrative Costs

- Salaries of administrative and clerical staff should be treated as “indirect” unless all of following are met:
  1. Such services are integral to the activity
  2. Individuals can be specifically identified with the activity
  3. Such costs are explicitly included in the budget
  4. Costs not also recovered as indirect
- Section 200.413
FAQ 4: Can I direct charge an accountant dedicated to the federal grant?

Consistent treatment of costs.

Consistent Treatment

NO Double Dipping!!!!

The rule:

- If you charge costs directly to your federal grants, you cannot include the same type of costs in your indirect cost pool, as this will result in double-charging of federal grants.
- 2 CFR 200.403(d)
For example:

Assume the grantee has an accounting office with 5 accountants and 1 of the accountants works exclusively on federal programs. The grantee has two options on charging accounting costs to federal programs:

1. the grantee could include the entire accounting office in the indirect cost pool (all 5 accountants – all charged to nonfederal funds), and recover the proportional accounting costs through the indirect cost rate;
2. the grantee could direct charge the single accountant to the federal programs and exclude all accounting costs from the indirect cost pool.

For example (cont):

Houston, we have a problem:

However, the grantee could not classify 4 accountants as indirect and include them in the indirect cost pool and classify 1 accountant as direct and direct charge that accountant to the federal programs.

This violates the “consistent treatment” rule and results in double-charging the federal program for accounting services because the federal programs are not receiving a benefit from the 4 accountants in the indirect cost pool.

The answer:

It depends. If the grantee does not include accountants in its indirect cost pool, then yes, the grantee may direct charge the accountant.*

*Assuming, of course, allowability rules are met.

What types of costs are included in your indirect cost pool!
FAQ 5: Can I use the de minimis indirect cost rate of 10%?

Ineligble to use the de minimis rate, according to ED:

- State and local governments
  - EDGAR 75.561 and 75.561 requires States to negotiate rates with LEAs; accordingly, these entities have a negotiated rate.
  - What about new LEAs/charters?
  - What if State only negotiated restricted rates, and LEA has never negotiated an unrestricted rate?
- Restricted rate programs
  - De minimis rate is an "unrestricted" rate. Cannot be used for programs with supplement not supplant provisions
- Training rate programs, as defined under EDGAR 75.562

NEW: De Minimis Rate

- Non-federal entities may receive a de minimis indirect cost rate of 10% of MTDC if the non-federal entity never had a negotiated indirect cost rate
- Received without any review of actual costs
- De minimis rate is allowable for use indefinitely

- Section 200.414(f)
  - But: State or Local Government and Indian Tribe receiving over $35M - Not eligible (Appendix VII)
For most education grant recipients...

- Generally no, you cannot use the de minimis rate.
- However, there may be circumstances in which a recipient would be eligible:
  - For example, if an SEA administers Child Care and Development Block grant and subgrants to a non-LEA that has never negotiated an indirect cost rate before.

FAQ 6: Can the pass-through entity further restrict my indirect rate?

Consistent application of negotiated rates.

NEW: Consistent Application of Negotiated ICRs

- Federal agencies must accept a non-federal entity's negotiated indirect cost rate.
- A different rate may be used for a class of Federal awards or single Federal award only if:
  - Required by statute or regulation (e.g. ED Restricted Rates_, or
  - Approval of Federal awarding agency head (per delegations authority) based on documented justification
- Further, deviations from negotiated rates must be publicly available, established in policies, and included in announcement of funding opportunity
- Federal awarding agency must notify OMB of any approved deviation
  - Section 200.414(c)
NEW: Requirements for Pass-through Entities

- Pass-through entities must provide an indirect cost rate to subrecipients, which may be the de minimis rate.
- Section 200.331(a)(4)

COFAR FAQs:

- Q. [P]ass-through entities are expected to honor a subrecipient's negotiated indirect rate agreement, or use a 10% MTDC de minimis rate, or negotiate a rate with the subrecipient. Is it acceptable to require a subrecipient to accept a rate lower than 10% MTDC, or in lieu of their negotiated indirect rate?
  - A. If the subrecipient already has a negotiated indirect rate with the federal government, the negotiated rate must be used. It also is not permissible for pass-through entities to force or entice a proposed subrecipient without a negotiated rate to accept less than the de minimis rate.

COFAR FAQs:

- Q. Can Federal awarding agencies and pass-through entities permit this practice when it is truly voluntary?
  - A. Yes. If a non-Federal entity receiving a direct Federal award or a subrecipient voluntarily chooses to waive indirect costs or charge less than the full indirect cost rate, Federal awarding agencies and pass-through entities can allow this. The decision must be made solely by the non-Federal entity or subrecipient that is eligible for IDC reimbursement, and must not be encouraged or coerced in any way by the Federal awarding agency or pass-through entity.
Soo...?

- No. Under the new rules, the pass-through entity cannot require a subgrantee to use a lower rate than what is available to them.

- What is available?
  - LEAs: Restricted/unrestricted rates negotiated with SEA
  - SEA must negotiate unrestricted rates for LEAs that want them.
  - Post-secondary institutions/nonprofits: SEA may negotiate restricted rate or require use of flat restricted rate of 8% of MTDC. EDGAR 76.564(c).
  - SEA cannot cap restricted rate at 5% or other figure below 8%
  - Negotiated unrestricted rate (with HHS, DOL, etc.) may be used for programs without supplanting provisions.

What if state law restricts the rate?

FAQ 7: Is there any UGG flexibility that education grantees can use?

Rate extension up to four years.
NEW: Extension of Negotiated ICR

- Entities with an approved federally negotiated indirect cost rate may apply for a one-time extension, without further negotiation subject to the approval of the negotiating federal agency.
- Extension for "up to" 4 years (may be fewer).
- Must renegotiate after extension to ensure rates continue to be based on actual costs.
- Section 200.414(g)

What’s the catch?

- Only applicable with predetermined rates.
- Remind me:
  - There are four types of indirect cost rates:
    1. Provisional
    2. Final
    3. Fixed with carry forward
    4. Predetermined
  - Most grantees use fixed with carry forward.
  - But grantees can convert to predetermined before making the extension request.

Rate extension continued.

- Requests for extensions must be submitted 60 days prior to the due date for indirect cost proposals.
- What documentation must be included?
  - ED has not said.
  - COFAR FAQs: "Documentation requirements … should be kept to a minimum."
  - HHS: submit a request along with the most current audited financial statements and a listing of the federal funding (awards) for the last 3 years. HHS will decide if a 4-year extension, or less, is warranted.
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