

# The Non-Uniform Guidance on Indirect Costs

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▶ “There is no universal rule for classifying certain costs as either direct or indirect.”

▶ 2 CFR 200.412

▶ But... there are guidelines

# Agenda

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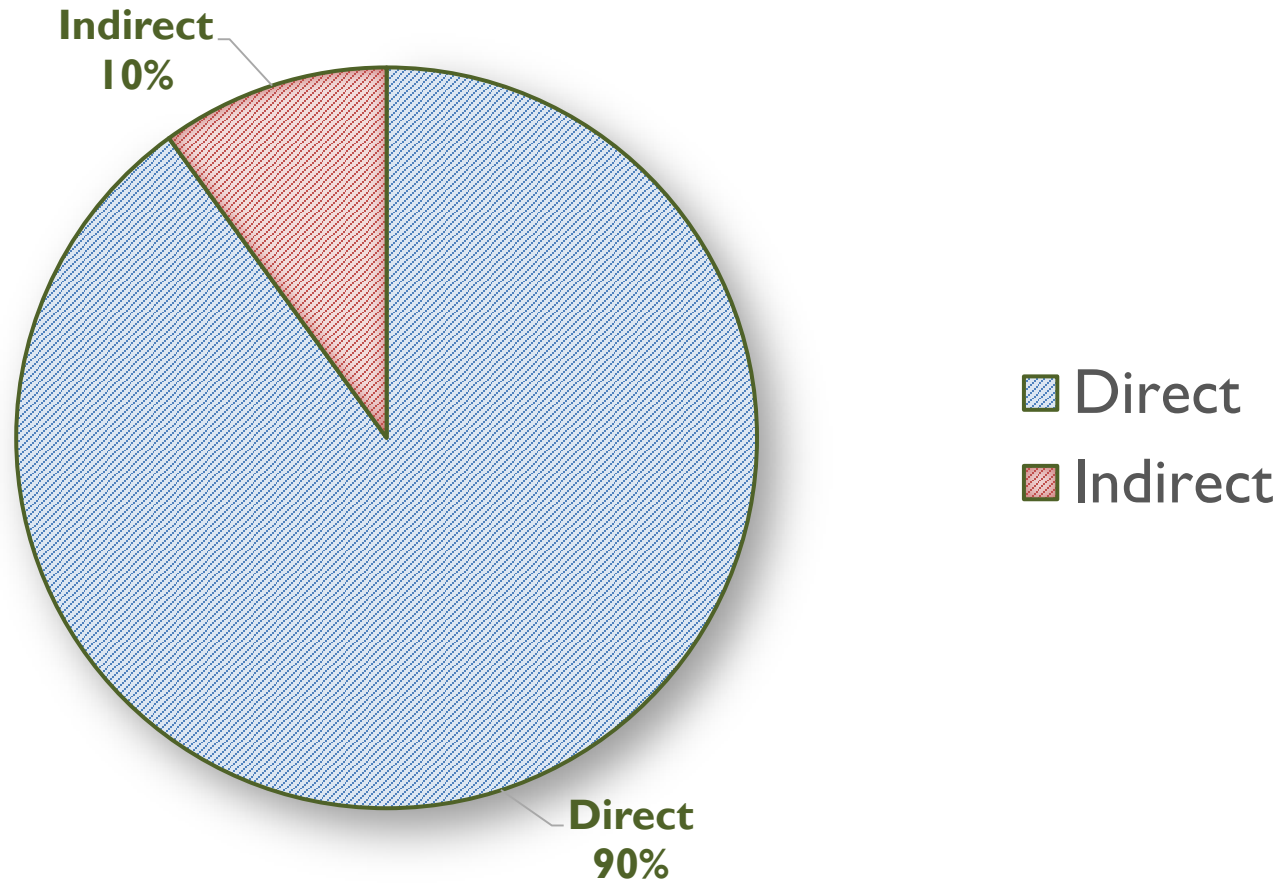
- ▶ General information
- ▶ Preparing indirect cost rate proposals
- ▶ Reimbursement of indirect costs
- ▶ Pass-through Requirements
- ▶ Common issues

# General information

The boring, but necessary basics.

# Total Cost of Federal Awards

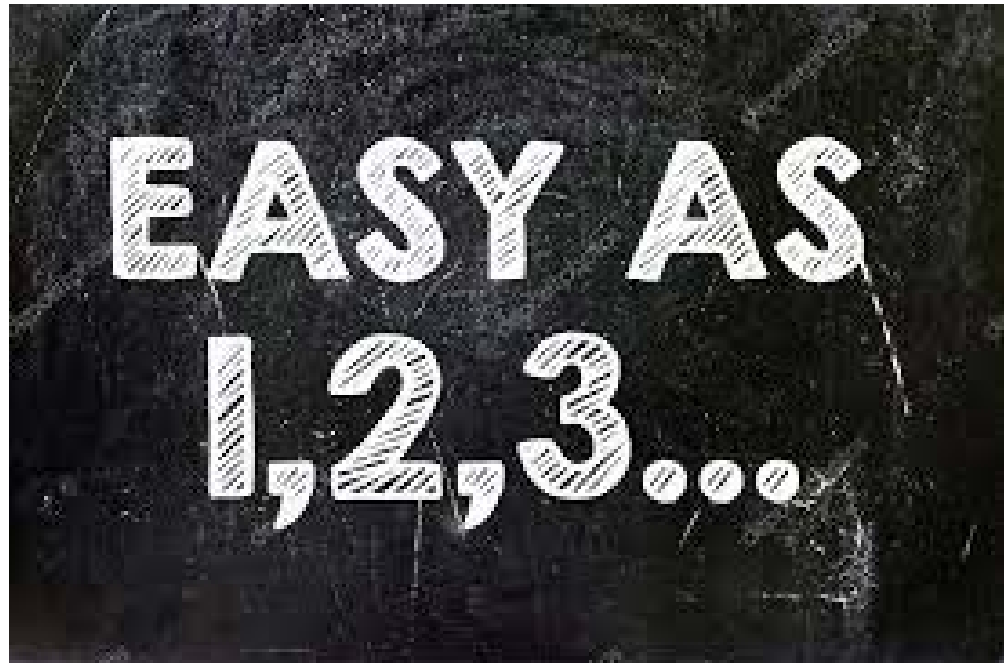
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# Allowable Costs

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- ▶ Reasonable
- ▶ Necessary
- ▶ Allocable



# Allocation Options:

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1. Direct Charge
  - ▶ Cost Allocation Plan
2. Indirect Costs/Facilities and Administrative (F&A) Costs



# Direct Allocation Example

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- ▶ You purchase a new copy/fax/printer machine for your Grants Office. You operate Grants A, B and C from the Office. How should you allocate the costs?





# Direct Allocation Example

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- ▶ Does this work?
  - ▶ 33% charged to Grant A
  - ▶ 33% charged to Grant B
  - ▶ 33% charged to Grant C

# Direct Allocation Example

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- ▶ What if, in this office, 3 people work on Grant A, 4 people work on Grant B, and 5 people work on Grant C.
- ▶ Does this work?
  - ▶ 25% charged to Grant A
  - ▶ 33% charged to Grant B
  - ▶ 42% charged to Grant C

# Direct Allocation Example

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- ▶ What if, each grant has its own code to use the copy/fax/printer – which generates a report of use, by grant, at the end of the year.
- ▶ Does this work?
  - ▶ At the end of the year, adjust charges to each grant to reflect the proportional use.

## Direct Allocation – 2 CFR 200.405(d)

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- ▶ If a cost benefits two or more project in proportions that can be determined without undue effort or cost, the cost must be allocated to projects based on proportional benefit.
- ▶ If a cost benefits two or more projects in proportions that cannot be determined because of the interrelationship of the work involved ... the costs may be allocated or transferred to benefitted projects on any reasonable documented basis.

# Indirect Allocation: It's a fraction!

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$$\frac{\text{Indirect Cost Pool}}{\text{Allocation Base}} = \text{Indirect Cost Rate}$$



# What the regs say

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- ▶ 2 CFR 200.412 – 200.414
  - ▶ Post-secondary institutions: Appendix III
  - ▶ Nonprofits: Appendix IV
  - ▶ State/local governments: Appendices VII

# What the regs say

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- ▶ **Rate Extensions**
- ▶ 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 the regs say

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- ▶ **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)



# What the regs say

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## 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

# Preparing indirect cost rate proposals

#ICRP



# How To Get An Indirect Cost Rate?

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- ▶ 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, State Education Agencies have methodology approved through “delegation authority” from ED. School districts must apply to SEA.

# How to Get an Indirect Cost Rate?

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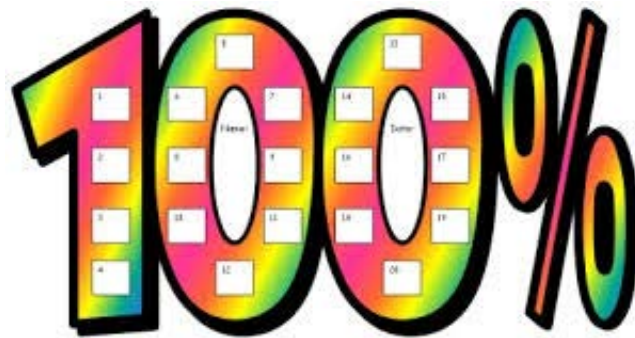
## ▶ 8-Step Guide



# 1. Determine total expenditures

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- ▶ Total costs, regardless of funding source, should be identified for each fund, function and object class (i.e. expenditure type)
  - ▶ Includes federal and nonfederal expenditures



## 2. Identify unallowable and excluded costs

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- ▶ Why??
- ▶ Certain costs are considered “distorting items” and may need to be removed from the numerator, denominator, or both when calculating your rate.
  - ▶ Unallowable costs
  - ▶ Pass-through funds
  - ▶ Subawards in excess of \$25,000
  - ▶ Other excluded costs

## 2. Identify unallowable and excluded costs

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- ▶ **Unallowable costs include:**
  - ▶ Debt service
  - ▶ Fines and penalties
  - ▶ Contingencies
  - ▶ Lobbying
  - ▶ Election expenses
  
- ▶ **\*If unallowable costs benefit from indirect costs, must be included in the base!**

- 
- ▶ Unallowable costs included in the base **LOWERS** your rate. Assume \$300 in unallowable costs that benefit from indirect (must be added to base):

$$\frac{\$100}{\$3,200} = 3.125\%$$

$$\frac{\$100}{\$3,500} = 2.857\%$$



## 2. Identify unallowable and excluded costs

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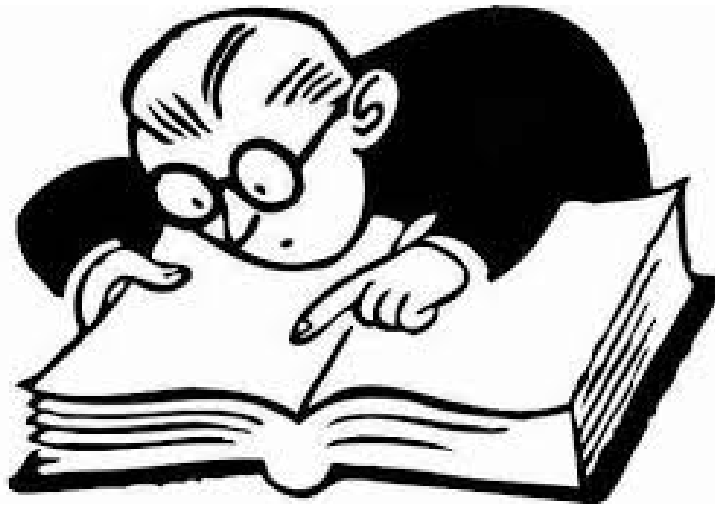
- ▶ Excluded costs (2 CFR 200.68):
  - ▶ Subawards in excess of \$25k
  - ▶ Equipment
  - ▶ Capital expenditures
  - ▶ Charges for patient care
  - ▶ Rental costs
  - ▶ Tuition remission
  - ▶ Scholarships and fellowships
  - ▶ Participant support costs



# Definition of “subaward” (200.92)

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



# What the Feds say...

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## Department of Labor:

- ▶ “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.”
  - ▶ <https://www.dol.gov/oasam/boc/DCCD-2-CFR-Guid-Apr2016.pdf>

## Department of Education:

- ▶ “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.”
  - ▶ <http://www2.ed.gov/policy/gen/leg/recovery/transcript11-02-09.doc>

# English Please!

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- ▶ Federal agencies 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.
    - ▶ COFAR FAQs, .68-1



Pro tip:

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The costs you exclude when developing your rate are the same costs you exclude when applying your rate for reimbursement

### 3. Determine direct costs

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- ▶ 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

## 4. Determine indirect costs

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- ▶ 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



## 4. Determine indirect costs

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- ▶ “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. I.



# Selected Items of Cost

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- 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)
- 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



# Selected Items of Cost

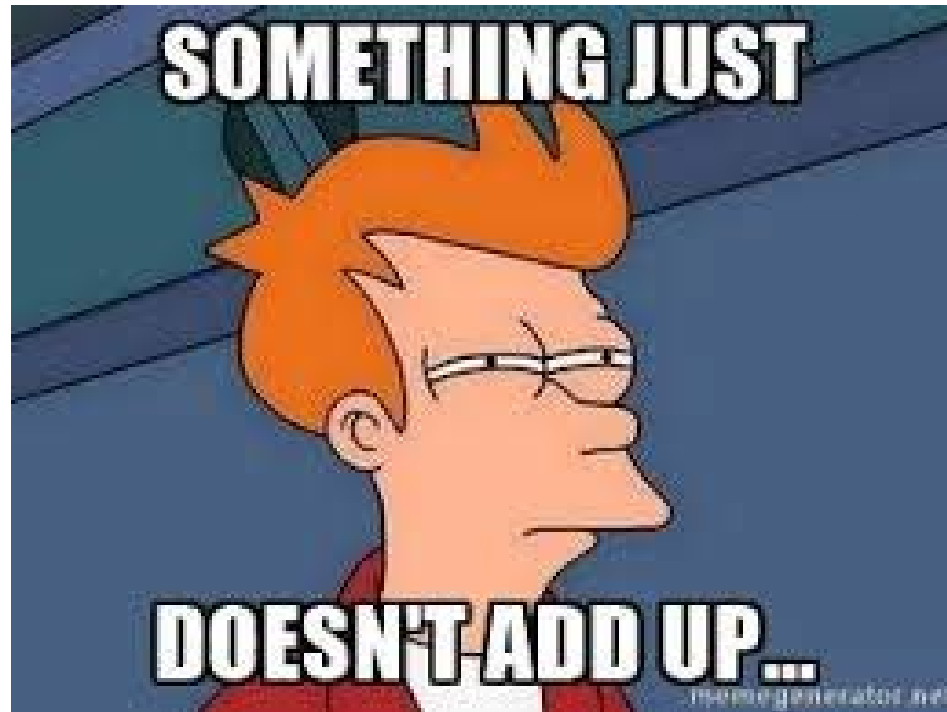
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- Depreciation is the required method for allocating the cost of fixed assets to periods
  - Use Allowance method no longer allowed
- Unused leave payments must be charged indirectly, 200.431(b)(3)(i)\*
- Actual claims for workers comp, unemployment compensation, severance pay, and similar employee benefits are allowable provided that they are allocated as indirect costs, 200.431(e)(3)\*

\*If nonfederal entity uses cash basis of accounting or if nonfederal entity uses specific identification for fringe benefits, then not required to charge these costs indirectly

## 5. Reconcile proposal to financial statements / expenditure reports

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## 6. Select the distribution base

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- ▶ Selection of the direct cost base is subject to negotiation and approval
  - ▶ Modifications to the base require prior written approval

Note for ED grantees and subgrantees:

- ▶ Restricted indirect cost rates must be calculated using a modified total direct cost base
- ▶ May convert to salaries and wages base (only after calculation)

## 7. Compute the indirect cost rate

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- ▶ It's a fraction!

$$\frac{\text{Indirect Cost Pool}}{\text{Allocation Base}} = \text{Indirect Cost Rate}$$



# Top: Indirect Cost Pool

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- ▶ 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)
- ▶ Must show benefit to federal program

## Bottom: “Modified Total Direct Cost Base”

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- ▶ All direct costs (All federal and non-federal expenses)
- ▶ Minus “distorting items” (i.e., “excluded costs”)



## 8. Complete indirect cost rate proposal documentation checklist

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- ▶ Capitalization Policy (including the capitalization threshold)
- ▶ Certificate of Indirect Costs
- ▶ Certification of Lobbying Costs
- ▶ Cost Policy Statement
- ▶ Cover Letter
- ▶ Depreciation Schedule
- ▶ Federal Grants and Contracts List
- ▶ Exclusions Schedule
- ▶ Financial Statements (e.g. CAFR Expenditures Report)
- ▶ Organization Chart and Profile
- ▶ Restricted Rate Adjustment Schedule
- ▶ Salary and Fringe Benefits Schedule
- ▶ Statement of Indirect Costs
- ▶ Statement of Total Costs (including carryforward schedule for fixed rate)
- ▶ Statewide Cost Allocation Plan (if applicable)
- ▶ Subawards and Subcontracts Schedule
- ▶ Unused Leave Schedule
- ▶ Trend Analysis
- ▶ Website Links to Accounting Policy Manual, and Listing of Funds, Functions and Object Codes



# Reimbursement of indirect costs

Show me the money!

# Applying the Rate

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- ▶ 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)

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<b><u>Incorrect Calculation</u></b>	
Total Award	\$4,000,000
	<u>\$4,000,000</u>
Rate Applied	20%
<b>Indirect costs</b>	<b>\$800,000</b>

<b><u>Correct Calculation</u></b>	
Total Direct Costs	\$3,350,000
Less: Equipment	(\$100,000)
Less: Subcontract	(\$2,550,000)
Plus: first \$25,000	<u>\$50,000</u>
MTDC Base	<u>\$750,000</u>
Rate Applied	20%
<b>Indirect costs</b>	<b>\$150,000</b>



# Applying the Rate - Frequency

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- ▶ 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)



# Budgeting indirect costs

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- ▶ Award: \$1,000,000
- ▶ ICR: 5%
- ▶ What to budget for indirect?\*
- ▶ \*SPOILER: it's not \$50,000

$$\frac{\text{Indirect Cost Rate}\%}{(1.0 + \text{Indirect Cost Rate } \%)} \times (\text{Total Award Less Distorting Costs (capital outlay, sub-awards in excess } \$25\text{k, etc.)})$$

# Budgeting indirect costs

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- ▶ Award: \$1,000,000
- ▶ ICR: 5%
- ▶ Maximum indirect recovery:

$$\frac{.05}{1.05} \times 1,000,000 = \$47,619$$

Direct costs: \$952,381

Indirect rate: \* 0.05

Indirect costs: \$47,619

# Administrative cost limitations

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Administrative costs may be direct OR indirect

## **Administrative Cost Cap**

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

# Administration vs. Indirect

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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!!!
  - ▶ E.g., if you have a negotiated F&A rate, admin cap would not apply to facilities rate – only administrative portion.
    - ▶ COFAR FAQs, .56-I



# Must my ICR be capped at the same percentage as my admin cap?

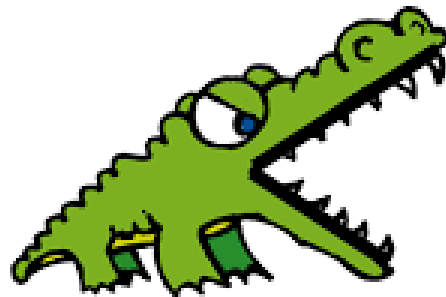
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- ▶ ABC subgrant has 5% cap on admin
- ▶ Post-secondary subgrantee has 8% restricted rate
  
- ▶ ABC subgrant = \$100,000
- ▶ Subgrantee spent \$96,000 on direct costs
  - ▶ \$46,000 went toward equipment, distorting items
  
- ▶ Applying the rate:  $\$50,000 * 8\% = \$4,000$
  
- ▶ Even if all indirect costs are “administrative”, subgrantee still does not exceed 5% cap in applying 8% rate.

# Must my ICR be capped at the same percentage as my admin cap?

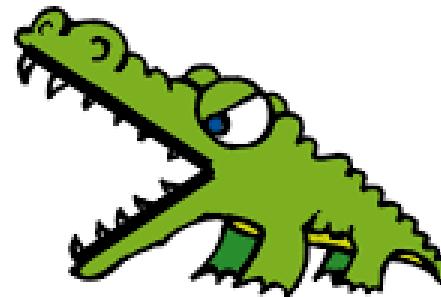
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- ▶ Not necessarily. If admin is capped at 5%, the grantee may still apply a higher indirect cost rate. However, recovery of indirect administrative costs and direct administrative costs must be within the 5% cap.
  - ▶ COFAR FAQ, .56-1



Less Than Gator

vs



Greater Than Gator

# Pass-through Responsibilities

Policies and procedures.

# Procedures

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- ▶ Pass-through agencies must have written procedures for determining indirect cost rates for subrecipients
  - ▶ § 200.414(e), § 200.331(a)(4), Appendices



- 
- ▶ Non-federal entities must obtain an indirect cost rate from their cognizant agency
    - ▶ 2 CFR Part 200, Appendices III, IV, and VII
  - ▶ Pass-through entities must provide an indirect cost rate to subrecipients, which may be the de minimis rate or may be a rate negotiated between the pass-through and the subrecipient.
    - ▶ 2 CFR 200.331(a)(4)

# COFAR FAQs:

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- ▶ 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:

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- ▶ 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.

# Common issues

Issues? What issues?



# Common issues

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## ▶ Compensation

### ▶ Time and effort

▶ Webinar March 14: <http://www.bruman.com/ensuring-allowability/>

### ▶ Retirement, leave, severance, etc.

## ▶ Unallowable costs

### ▶ Don't forget related indirect!

## ▶ Credits

### ▶ Receipts, refunds and adjustments applicable to direct costs charged must be credited to the award

### ▶ Credits applicable to indirect costs must be credited to the indirect cost pool

# Common issues (cont.)

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- ▶ Interest
  - ▶ Ask a CPA
- ▶ Depreciation/use allowance
  - ▶ Ask a CPA
- ▶ Subawards
  - ▶ See slides above
- ▶ Unsupported costs
  - ▶ Document indirect costs through rate proposal
- ▶ Consistent treatment of costs
  - ▶ No double dipping! 2 CFR 200.403(d)



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