Indirect Cost Rates – Which is Right for Your CAP

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Agenda

1. Key Terms and Concepts
2. Classifying Costs
3. Cost Allocation Plans
Key Terms and Concepts
When to make allocations…

Allocations can be between:

• Across all grants and activities
  – LIHEAP, Weatherization, CSBG, Head Start, WIC, etc.

• Funding sources in the same grant
  – Federal and state grant

• Programs from the same funding source
  – WIOA Youth and Adult
  – Head Start and Early Head Start

• Categories within a program
  – Administrative and program
Subpart E: Cost Principles

Basic Considerations
- Reasonable
- Allocable

Types
- Direct costs
- Administrative costs
- Approved indirect cost rates

Selected Items of Cost
- Allowable
- Unallowable
- Prior Approval

2 CFR Part 200, 45 CFR Part 75
Subpart E. Cost Principles – General Provisions

§ 200.403 Factors affecting allowability of costs

• Be necessary and reasonable
• Conform to limitations
• Be consistent with other organization activities
• Be treated consistently
• Be determined in accordance with generally accepted accounting principles, as appropriate
• Not be included as cost or match in any other federally funded program (*current or prior*)
• Be adequately documented

45 CFR 75.403
§ 200.404 Reasonable Costs

A cost is reasonable if, in its nature or 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 costs. Consideration must be given to:

- Ordinary and necessary
- Sound business practices, arms length bargaining, laws, regulations, and terms
- Market prices
- Individuals acted with prudence
- Significant deviations from established practices and policies which may unjustifiably increase cost

45 CFR 75.404
§ 200.405 Allocable Costs

(a) A cost is allocable to a particular Federal award or other cost objective if the goods or services involved are chargeable or assignable to that Federal award or cost objective in accordance with relative benefits received. Standard met if cost:

- Specific for the award
- Benefits the award and other work
- Can be distributed in approximate proportions using reasonable method
- Necessary to overall operation of entity
- Assignable in accordance with Uniform Guidance

45 CFR 75.405
§ 200.405 Allocable Costs

(b) All activities which benefit from the non-Federal entity's indirect cost, including unallowable activities and donated services, will receive an appropriate allocation of indirect costs.

(c) Any cost allocable to an Federal award may not be charged to other Federal awards to overcome fund deficiencies, to avoid restrictions imposed by Federal statutes, regulations, or terms and conditions of the Federal awards, or for other reasons.

45 CFR 75.405
If a cost benefits two or more projects or activities in proportions that can be easily determined, the cost should be allocated to the projects based on the proportional benefit.

If a cost benefits two or more projects or activities in proportions that cannot be determined because of the interrelationship of the work involved, then the costs may be allocated on any reasonable documented basis.
Classifying Costs
There are 2 ways to do cost allocation:

**Direct Cost Method**
- Allocate costs based on relative benefit received
- Charge shared costs to programs based on an activity or other non-monetary base

**Indirect Cost Rate**
- Used to allocate indirect costs
- Method for determining, in a reasonable manner, the proportion of indirect costs each program should bear
- Ratio of indirect costs and a direct cost base
NEW § 200.412 Classification of costs

There is no universal rule for classifying certain costs as either direct or indirect (F&A) under every accounting system.

It is essential that each item of cost incurred for the same purpose be treated consistently in like circumstances either as a direct or an indirect (F&A) cost.
Direct Cost Allocation

- Should be supported by current data
- All benefiting cost objectives participate
- Costs have to be allowable to all benefiting programs
§ 200.413 Direct Costs

(c) NEW Salaries of administrative and clerical staff should normally be treated as indirect. Direct charge only if all of the following are met:

(1) Administrative or clerical services are integral to the project,

(2) Individuals involved can be specifically identified with the project,

(3) Such costs are explicitly included in the budget or have prior written approval, and

(4) The costs are not also recovered as indirect.

45 CFR 75.413
Direct Allocation Plans

Identify the costs to be allocated and measures of activity that will fairly allocate the costs

- **Type of Expense**
  - Shared vehicle
  - Food preparation
  - Building and maintenance

- **Non-monetary Allocation Base**
  - # of miles driven
  - # of meals served
  - # of square feet
§ 200.414 Indirect Costs

(c)(1) Negotiated rates must be accepted by all Federal agencies; May use a different rate only when required by statute or regulation

(c)(4) Awarding agency must include in NOFO policies relating to indirect cost rate reimbursement, matching, or cost share

(d) Pass-throughs subject to 2 CFR 200.331

(e) Appendix IV - cost allocation for nonprofits & Appendix V - cost allocations for units of government

45 CFR 75.414
§ 200.414 Indirect Costs (cont.)

(f) **NEW** Any non-Federal entity that has never negotiated an IDCR may elect to charge a de minimis rate of 10% of modified total direct costs (MTDC) which may be used indefinitely.
(g) **NEW** Any non-Federal entity that has a current federally negotiated indirect cost rate may apply for a **one-time extension** of the rate in that agreement for a period of **up to 4 years**

- **Must be approved by a cost negotiator**
- **If approved, may not request a rate review until the extension ends**
- **At end of extension, must apply for a new rate**
- **Subsequent one-time extensions (up to 4 years) are permitted if approved**

45 CFR 75.414
**Indirect Cost Rates**

**De Minimis (10%)**
- Flat rate, without regard to actual expenses
- No approval required to use
- May not recover all indirect costs or may have a residual
- Do not have to prove costs
- May only use a specific allocation base
- May use indefinitely

**Negotiated**
- Based on actual expenses (most recent audit)
- Approved by federal negotiator (cognizant agency)
- Will allocate all costs in the cost pool
- Provide details of costs
- May choose from allowable allocation bases
- Must re-negotiate each year, but may request extension of certain rates
Negotiated indirect cost rate general formula

\[
\frac{\text{Indirect Costs} \, \$}{\text{Direct Cost base} \, \$} = \% 
\]

Costs in the negotiated indirect cost pool are:

- Allowable and
- Benefit ALL programs
Indirect Cost Pool

What does not go into the Negotiated Cost Pool?

- Do not include costs that are
  - Capital expenditures
  - Losses on awards
  - Unallowable costs
  - Expenditures that benefit some, but not all, programs

What about the de Minimis Cost Pool?
What **might** go in the Indirect Cost Pool?

Who’s watching the pool?
<table>
<thead>
<tr>
<th>Item</th>
<th>In the indirect cost pool</th>
<th>Not in the indirect cost pool</th>
<th>Need more information</th>
</tr>
</thead>
<tbody>
<tr>
<td>Salary of the accounts payable clerk</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Salary of the Chief Program Officer</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Salary of the Weatherization accountant</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Child care fees that were written off because the parent didn’t pay</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>100% of the costs of the office of the Executive Director</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
## Exercise – Indirect Cost Pool

<table>
<thead>
<tr>
<th>Item</th>
<th>In the indirect cost pool</th>
<th>Not in the indirect cost pool</th>
<th>Need more information</th>
</tr>
</thead>
<tbody>
<tr>
<td>Costs of preparing a proposal for a new grant which the Organization won</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loss on a program funded by a state grant</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fundraising costs</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Worker’s comp claim paid for a former Senior Services program employee</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Program Administration costs for Head Start Program</td>
<td></td>
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</tbody>
</table>
Types of Negotiated Indirect Rates

Predetermined – Based on estimated costs to be incurred during the rate period (may be longer than 1 year)

Fixed rate with carry-forward – Based on estimated costs to be incurred during the fiscal year

Provisional rate – temporary rate issued for use during the fiscal year

Final rate – based on actual allowable costs and applied to the previous year

Can apply for the one-time extension of the Predetermined or Final rate
Indirect Cost Rates

Bases:

• **Modified Total Direct Costs (MTDC)**
  – Total direct salaries and wages, applicable fringe benefits, materials and supplies, services, travel and subawards up to the first $25,000
  – Excludes equipment, capital expenditures, participant support costs and the portion of each subaward in excess of $25,000
  – This is the required base for the 10% de minimis rate

• **Direct salaries and wages**

• **Direct salaries, wages and fringe benefits**
### Distribution Base – Example

<table>
<thead>
<tr>
<th></th>
<th>Total Direct Costs Base</th>
<th>Direct Salaries &amp; Wages Base</th>
<th>Direct Salaries, Wages, Benefits Base</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indirect Costs</td>
<td>$1,501,633</td>
<td>$1,501,633</td>
<td>$1,501,633</td>
</tr>
<tr>
<td>Base</td>
<td>$14,430,044</td>
<td>$8,144,827</td>
<td>$12,013,964</td>
</tr>
<tr>
<td>Rate</td>
<td>10.41%</td>
<td>18.44%</td>
<td>12.50%</td>
</tr>
</tbody>
</table>

Is rate one better than the others? **No** – they all produce the same results in total.

The difference is in how they impact specific grants.
What are the advantages of a negotiated indirect cost rate agreement?

- Provides for one method to allocate *almost all* administrative costs.
- Potentially can make budgeting easier – direct salaries might be easier to estimate than the number of transactions Finance will perform.
- Rate and method are federally approved.
Indirect Cost Rates

What are the disadvantages of a negotiated indirect cost rate agreement?

- Rate and method are federally approved – subject to individual cost negotiator preferences
- May lose some flexibility in how you determine the manner in which programs are charged for administrative costs
- May need to finalize and get approval for the rate every year
- Inconsistencies in charging the rate to nonfederal funding sources
Cost Allocation Plans
Cost Allocation Plan

Must have written procedures for determining allowability of costs

2 CFR Part 200.302(b)(7), 45 CFR 75.302(b)(7)

A cost allocation plan should be the simplest, most straightforward way to *fairly* allocate costs

The plan must *easily* communicate that the agency is distributing shared costs fairly and following the regulations
Description of the process for allocation:

- **How**: Through an allocation module in your accounting system, spreadsheets, separate software, manually
- **When**: Timing of allocations (monthly, quarterly)
- **Who**: Responsibilities for determining allowability and allocability
  - Reference approved financial policies and procedures
Cost Allocation Plan

Information on the sources of revenue for each program, including any statutory limitations

• Head Start Grantee, Workforce Development

Description of the costs to be allocated

• Administrative services such as Human Resources and Accounting
Cost Allocation Plan

Description of the methods used to allocate costs

• Distribution base for shared costs
  – Direct costing – activity base such as number of children
  – Indirect cost rate – salaries and wages

• How indirect costs will be charged
  – Negotiated rate
  – De Minimis rate
  – No allocation
## Example Cost Allocation Chart

<table>
<thead>
<tr>
<th>Allocated Cost</th>
<th>Allocation Base</th>
<th>Rationale</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Human Resources Dept. costs include:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• All HR staff costs including salaries, wages and benefits</td>
<td>Number of employees</td>
<td>Number of employees drives the need for HR staff and resources</td>
</tr>
<tr>
<td>• Space costs for the HR dept.</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Facilities management, costs include:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• All Facilities staff costs including salaries, wages and benefits</td>
<td>Number of square feet occupied</td>
<td>Number of square feet maintained correlates directly with the Facility dept. costs.</td>
</tr>
<tr>
<td>• Supplies</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Direct Cost Allocation – when to do it

Real-time allocations – allocated to programs and grants as soon as the cost is entered into the accounting system.

- *Example: rent expense allocated when paid*

Month-end allocations – allocated after month end.

- *Similar costs are combined in a separate project code (or similar) and are allocated out*
Cost Allocation Plan Implementation

Allocation method is a management decision, not a funder decision

Fiscal policies and procedures

Document, review, update cost allocation plan

- Negotiated rate or de minimis, allocation units

Classify costs to determine if a cost is

- Direct
- Indirect
- Shared costs
Cost Allocation Plan Implementation

System set-up

• How will shared costs be accumulated and allocated?
• How will indirect costs be accumulated?
• Update distributions
  – Allocation units, distribution codes

Allocate shared costs and apply the indirect rate

Review reports

• Train staff
Cost Allocation Common Findings

- Not allocating shared costs to all benefitting programs
- Not obtaining a new indirect cost rate annually
- Continuing to use a rate that is no longer in effect
- Not revising the cost allocation plan or indirect cost rate proposal to include the addition or loss of program
- Not maintaining supporting documentation
Cost Allocation Lessons Learned

• If you change cost allocation methods, you will get different results.

• Communication with program managers is very important. They need to understand what will be charged to their grants and why.

• Program managers may not perceive they receive value for allocation costs, so there can be cultural issues with cost allocation.
Considerations

Subrecipient – Indirect Cost Rates

- PTEs accept federally negotiated rate; negotiate one
- Approvals must be based on Uniform Guidance cost principles
- Procedures followed in evaluating and approving the subrecipient’s indirect cost proposal should be documented and are subject to review
Considerations

What about grants that disallow some costs or limit the amount of administrative costs it reimburses/pays?

- You are required to charge all programs fairly and follow your cost allocation plan
  - Allocate first, report second
  - Request reimbursement from funding sources according to grant requirements, but charge all costs according to your plan
Cost Allocation Plan

Aim for fairness, not precision
• Each program should bear its fair share of cost

Simpler is better
• Can you easily explain your cost allocation methods to managers and funders?

Don’t spend $2 to allocate $1
• Are “nested” allocations worth the effort?
Cost Allocation Plan

Design methods that can done in your accounting system

- Use distribution codes or cost pools.
- System cost allocation module; caution use of spreadsheets

You will never find a method that satisfies everyone.

When you apply for a grant that has little or no administrative money, plan how you will cover those costs before you get the grant.
If you have multiple funding sources, cost allocation is unavoidable.

The results of cost allocation may force you to critically review your administrative costs – are they too high?

Questions?
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