

# Indirect Cost Rates

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FEDERAL GRANTS FORUM, SESSION 8

APRIL 6, 2017

# Federal Grants Forum

## Session 8: Indirect Costs Rates

### Learning Objectives

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- Distinguish between direct and indirect costs.
- Recognize changes to indirect costs.
- What are the types of indirect costs rate and base.
- Review considerations and deciding to obtain an indirect cost rate.

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# A Few Words

## *The Uniform Guidance*

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The Office of Management and Budget (OMB) merged eight previously separate OMB grant circulars into 2 CFR 200, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards.

This document is a uniform grant guidance for all Nonfederal Entities and is commonly referred to by several names, the uniform guidance, super circular or omnibus circular.

There are going to be differences because there are different types of nonfederal entities (State and Local governments, nonprofit organizations, Indian Tribes and Institutions of higher educations).

Accordingly, differences are in the provisions for indirect costs.

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Reference documents for indirect cost and cost allocation plans are found in 2CFR200, subpart A, for definitions, subpart D for post award issues, subpart E, cost principles and appendices III-VII, in addition to appendix VIII, which is a listing of nonprofit organizations that operate as commercial, for-profit organizations and are treated accordingly (so they do not use Appendix E as their cost principles – they use 48 CFR 31.2) and Appendix IX for hospitals.

Also reference, program law for restrictions that may prohibit indirect cost as an allowable cost or place limitations on the amount of administration maybe charged on the award or indirect limitations set by caps.

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### Indirect Cost Rate Proposals

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- Purpose of the Indirect Cost Rate Proposal
  - Obtain reimbursement of organizational operational cost.
  - Prepared from audit financial statements and adjusted for unallowable cost.
  - Identifies all direct and all indirect cost.
  - Selects a direct cost base.
  - Divide the IDC pool by direct cost base.
  - Results is a Rate calculation, expressed as a percentage.
  - Formula would be IDC divided by DCB equals Rate ( $IDC/DCB = RATE$ ).
  - Apply rate to each program. Rate times DCB equals indirect cost charged each program.

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### Complex Process

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- Time consuming.
- Meticulous detail.
- Must do annual reconciliation by fiscal year.
- Requires knowledge and skills to develop and manage properly.
- Must list all direct and indirect costs.
- Many nonfederal entities forego the burdensome process.
- Then what are the alternatives?

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# Learning Objective #1

*Distinguish between direct and indirect costs  
(IDC)*



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### Definitions and Cost Principles

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- Definitions in Subpart A
  - Differences between direct and indirect costs.
  - Types of expenses.
- Cost principles in Subpart E
  - Indirect costs are based on cost principles.
  - Allowable and unallowable costs.

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### Direct Costs ( § 200.413)

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- Direct costs are those costs that can be identified specifically with a particular final cost objective, meaning federal award, program or project. Some cost are straight forward and some are more difficult. Cost that specifically benefit the awards are charged to that award. Examples are those identified on SF-424a budget as direct cost.
  - Staff salaries.
  - Materials and Supplies
  - Equipment.
  - Contractual.
  - Travel and Other direct cost.

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### Indirect Costs ( § 200.56, 200.414 and Appendices III-IX)

- Indirect costs are costs for a common or joint purpose within a NFE and that benefit all programs or projects. Examples may include:
  - CEO and CFO
  - Payroll processing and accounting.
  - Procurement Office
  - Property offices.
  - Human Resources (HRM).

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### Expenditures ( § 200.34)

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- “Expenditures means charges made by a nonfederal entity to a project or program for which a federal award was received.”
  - Direct expenditures or costs.
  - Indirect expenditures or costs.
  - Administrative costs (direct or indirect, but not both)
  - Accral or cash basis.

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### Administrative Costs ( § 200.56, § 200.414)

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- Administrative costs are operational costs that are assigned to a particular project.
  - Progress reporting by the PI/PD
  - Some clerical (support for PI/PD, registrations)
- May have limitations.
- May be direct or indirect, not both, consistent treatment.
- Institutions of higher education have special limitation (cap) on administrative costs (F&A).

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### Modified Total Direct Costs (MTDC) ( § 200.68)

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- MTDC means all direct salaries and wages, fringe benefits, materials and supplies, services, travel, and subawards and subcontracts up to the first \$25,000.
- MTDC excludes equipment, capital expenditures, charges for patient care, rental costs, tuition remission, scholarships and fellowships, participant support costs and the portion of each subaward and subcontract in excess of \$25,000.

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### Rules for Determining the Difference (§200.412)

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- There is no universal rule for classifying certain costs as either direct or indirect.
- Each item of cost should be treated consistently to avoid possible double-charging of federal awards.

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### Consistency (§200.400(e))

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- In reviewing, negotiating and approving cost allocation plans or indirect cost proposals, the cognizant agency for indirect costs should generally ensure that the nonfederal entity is applying costs on a consistent basis.



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### Process for Indirect Costs

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- Nonfederal entity submits annual proposal to federal “cognizant agency for indirect costs.”
  - Sometimes OMB specifies cognizant agency.
  - Usually, the agency that awards the most funding to the nonfederal entity.
- Cognizant authority may be delegated to pass-through entities.

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### But Now another option, 10 Percent Flat Rate/De Minimis Rate

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- No calculation – a simple 10 percent of MTDC
- Maybe used immediately.
- No annual proposal.
- Does not define what costs are indirect.
- Does not define what costs are direct.

How would a nonfederal entity define its direct and indirect costs? How would a nonfederal entity demonstrate that it would apply direct and indirect costs consistently?

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### *De Minimis* Rate

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- Written policy or certification.
  - To define costs as designated direct or indirect.
  - To demonstrate consistent application of costs.
  - To provide “reasonable assurance” (internal controls §200.303) that costs would not be double-charged as both direct and indirect.

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# Learning Objective #2

*Recognize Changes to Indirect Costs*

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### Acceptance of Rate (§200.414(c)(1))

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- Federal agencies and pass-through entities must accept a nonfederal entity's approved negotiated rate unless there is a program statute or approved agency regulation otherwise.
- The negotiated IDC agreement stands as agreed to and a federal agencies (FA) or pass-through entities (PTE) cannot restrict or deny any indirect costs.

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### Pass-through Entities (§200.331)

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- Pass-through entities must accept a subrecipient's federally approved negotiated rate, or if there is no rate:
  - Negotiate an IDC rate for said subrecipient requesting, or
  - Allow the 10 percent de minimis rate to eligible subrecipients, never had an IDC rate.

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### Extension of Rate (§200.414(g))

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- A nonfederal entity that has a federally negotiated indirect cost rate may apply for an extension of a current final indirect cost rate for a period of up to four years.
- Renegotiated after extension period (four years).
- Requires prior written approval.

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### Unrecovered Indirect Costs (§200.306(c))

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- Unrecovered IDC results from expenses in the pool exceeding the revenue received from each program. An example is a NFE that spent \$500K in IDC pool and received \$450K from programs using the services. Rate % X DCB for each program equals money that goes to pay pool expenses.
- The deficit must be corrected (eliminated) and that is usually accomplished by bring revenue in line with expenses. Deficits are normally resolved from nonfederal funds (NFF) since this is not an allowable cost for federal awards. Each program is to pay its proportional share of nonfederal funds.
- Accordingly, a program that has nonfederal share requirements (matching or cost sharing) may have their nonfederal share IDC deficit used to satisfy program matching or cost share requirements, with the prior approval of their FA.



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### Closeout and Adjustments (200.343, 344, 345)

- Submit final FFR SF-425 which contains both direct and indirect cost.
- Then after audit, submit an adjusted FFR in agreement with audited (SEFA) balances for each program.
- Obligations to return any funds due to later refunds, corrections or transactions including a final indirect cost rate adjustment.
- If collections are not paid in 90 days, federal claims act is to be engaged by FA or PTE and interest is to be charged on collection amounts at the prime rate.

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### Certification (§200.415)

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- To assure that expenditures are attested to as allowable cost.
- Signed by an official who is authorized to legally bind the nonfederal entity.

“By signing this report, I certify to the best of my knowledge and belief that the report is true, complete, and accurate...I am aware that any false, fictitious, or fraudulent information, or the omission of any material fact, may subject me to criminal, civil or administrative penalties for fraud, false statements, false claims or otherwise. (U.S. Code Title 18, Section 1001 and Title 31, Sections 3729–3730 and 3801–3812).”

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# Learning Objective #3

## *Different Indirect Cost Rates*

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### Types of Rates (§200.414)

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- Provisional/Final.
- Predetermined.
- Fixed with carry-forward.
- De minimis or 10 percent flat rate. MTDC base required.

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### Special Rate for IHE Facilities and Administrative .414

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- Facilities and Administrative (F & A).
- Facilities address campus buildings and related cost i.e. property taxes, maintenance, insurance and etc.
- Administrative addresses general operational cost.
- Fringe benefits maybe be calculated through a type of indirect cost rate.

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### Provisional Rates (200.414, Appendix IV, C 2 f)

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- Temporary rate agreed to for a period of time, NFE fiscal year, so that indirect cost maybe charged against federal awards.
- Will be adjusted upon actual cost for period. Actual cost are determined by NFEs single audit.
- Negotiated with NFE Cognizant agency.
- Requires upward or downward adjustments.

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### What are the benefits/risks?

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- Benefit: It enables a nonfederal entity to use an indirect cost rate to immediately charge federal award.
- Risk: If the final rate is significantly different from the initial rate, the nonfederal entity will face adjustments that could create cash flow or other financial burden.

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### Final Rates (200.414, App. IV.C.1.d & C.2.f)

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- Means an IDC rate applicable to a specified past period which is based on actual cost for said period.
- Actual costs are audited cost for period.
- Final rate is not adjustable.
- Final rates can change from year to year.



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### Preetermined Rates (200.414, App. IV.C.1.b)

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- Means an IDC rate applicable to a specific current or future period of time usually NFE fiscal year.
- Based on estimated costs.
- Best for stable recipients, organizational structure firm no changes, receive same level of funding each year with little fluctuation. Not subject to adjustment.

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### Fixed Rate with Carry Forward (App. IV.C.1.c & C.2.e.)

- Same characteristics as a predetermined rate, except that differences between estimated and actual cost for the period.
- This difference is carried forward as an adjustment to the rate computation of a subsequent period.
- This rate allows the NFE to break even over a two year period.
- Cannot be extended four years (200.414(g)).

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### De Minimis (Flat Rate) of 10 Percent (§200.414(f))

- A nonfederal entity that has never received a negotiated indirect cost rate, except for those nonfederal entities described in Appendix VII, may elect to charge a de minimis rate of 10 percent of modified total direct costs (MTDC) which may be used indefinitely.
- Costs must be consistently charged as either indirect or direct costs, but may not be double-charged.
- No formal written policies have been developed by FAs. A NFE developing policies and procedures before implementing would be a best practice.

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### Benefits:

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- No complicated work papers, forms or negotiations which are usually timely.
- No negotiation needed. Declare, certify, FA or PTE approval and implement.
- May use indefinitely until the nonfederal entity chooses to negotiate a rate (200.414(f)).

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### Risk:

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- Must charge all programs 10% MTDC.
- Must develop own internal policies and procedures based on current FA IDC guidance.
- There are no previous models to operate from, nothing tested or success stories.

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Let your direct cost base (DCB) ensure an equitable distribution of IDC. Types of DCB:

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- Salary and Wages – for NFEs that administer programs that are labor intensive.
- Salary and wages and fringe benefits – fringe benefits make a difference and programs are labor intensive.
- Total direct cost (TDC) – total of all cost categories (account) expenditures. For multiple types of programs.
- Modified total direct cost (MTDC) – total cost less distorting items and unallowable. For multiple types of programs.

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### Complicating Factors – Decision making is difficult:

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- Numerous types of rates and DCB.
- Some rates require adjustments.
- Are you concerned about a High or low rate percentage?
- Disallowed costs are normally repaid with nonfederal funds.
- Adjustments can challenge cash flow and fund balances.
- De minimis rate is targeted to specific nonfederal entity that must define and document indirect and direct costs.
- Negotiated rates must be renegotiated each year, unless eligible for extension.
- Some rates can be extended up to four years.

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# Learning Objective #4

*Considerations for indirect cost rates*



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### To Pursue or Not Pursue a Negotiated Indirect Cost Rate

- Takes time to prepare proposal.
- Requires knowledge and skills.
- Need resources to prepare the proposal.
- Requires review and negotiation of the proposal.
- Often subject to audit findings.
- Requires written policy and procedures.
- Once approved, awarding agencies (FAs) must accept it unless there is a program statute or regulation otherwise.

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### To Charge or Not To Charge Indirect Costs

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- If indirect costs are not charged, our alternative is to charge operational cost directly.
- Recipient program staff generally like direct costs, financial and administrators prefer IDC.
- Awarding agencies generally prefer indirect direct costs.
- Charging indirect costs shares or spreads operational financial cost within NFE programs.

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### To Charge or Not To Charge Indirect Costs

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Unless there is a program statute or regulation to the contrary, it is the recipient organization's choice to charge indirect costs or waive some or all of its indirect costs.

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### To Use or Not To Use a Provisional Rate.

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- It enables nonfederal entities to charge indirect costs before a final rate is approved.
- It is a risk that can cause cash flow adjustments upward or downward after the final rate is approved. So, it is imperative to manage.

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### To Use or Not To Use the De Minimis Rate

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- Must be eligible.
- Never had a negotiated rate.
- Under a certain threshold of awards.
- Based on MTDC which is the most challenging base to manage.
- All NFEs should understand allowable cost and have an accounting system to properly account for direct and indirect cost.
- Provide reasonable assurance that – no double dipping will occur!
- Create internal policy and procedures to manage.

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**TAKE AWAYS!**

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### Common Audit Findings

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- Time and effort reporting.
- Improper documentation.
- Inadequate accounting system.
- Lack of written policies and procedures.
- Allocation basis improper.
- Unallowable cost charged to direct and indirect cost.
- Lack of internal controls.
- Indirect cost charged as direct.
- Subrecipients not monitored by PTE.





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**Wrap Up !**  
**Questions?**

**EXAMPLES OF OVERHEAD COST FROM BUSINESS  
AND NON-FEDERAL ENTITIES**

<u>TYPE OF BUSINESS</u> <u>STARBUCKS.</u>	<u>ADMINISTRATIVE COST</u> <u>NDIRECT COST/OVERHEAD</u>	<u>FFA/ PL 95-224</u> <u>NONFEDERAL ENTITY</u>
Personnel - HRM. CFO Accounting Office Procurement Office Facilities/Property Office	Operational Infrastructure.  Corp. Travel Office	BUSINESS MGMT SYSTEMS HRM, Financial Mgmt., Procurement, Property, & Travel Management
Risk Management. Intellectual Technology Internal Audit Section. Corp. Attorneys Senior Management. Board of Directors.	CEO, CFO & STAFF.	Risk Mgmt. Insurance IT - Intellectual Tech. Internal Audit Legal Staff Senior Management Board, Council, Commission
Corporate Financial Audit (GAAP) Other		Single Audit Depreciation

**Indirect Cost - Administrative. Cost - Overhead Cost  
FOR A BUSINESS AND A NONFEDERAL ENTITY (NFE)**