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Indirect Cost Rates and Cost Allocation Issues and Requirements: Guidance for Complying with the Uniform Grants Guidance

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PRESENTER: EDWARD "TED" WATERS

- Well known for his expertise in federal grants, government reimbursement, payment and administrative issues, and his strategic handling of organizations facing crises, Ted was again selected this year as a "Super Lawyer" for Health Care in Washington, D.C.
- Ted has been counsel to numerous health centers and other recipients of federal funds in the past 25 years as well as many other entities such as managed care organizations and federal contractors, and has represented clients in front of federal and state courts, administrative tribunals, Offices of Inspector General and federal agencies to name a few.
- Ted has been Managing Partner of Feldesman Tucker since 2003 and in 2013 started the first law school class in the country on federal grant programs at the George Washington University School of Law.
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AGENDA

I. PRELIMINARY MATTERS

II. THE "ALLOWABLE COST" SYSTEM

  a. The Grant Agreement

  b. Basic Requirements for an Allowable Cost

III. COST ALLOCATION AND INDIRECT COSTS

  a. Direct Costs vs Indirect Costs

  b. Direct Charging

  c. Indirect Allocation Methodologies

  d. Types of Indirect Cost Rate Agreements

  e. How do I go get an ICRA

IV. QUESTIONS

HOW IS THE U.G.G. LAID OUT?

- 2 C.F.R. part 200 or for HHS 45 C.F.R. part 75
  - Other OMB circulars removed from C.F.R.
  - Modeled after the Federal Acquisition Regulations, Federal Agencies' codifications to follow at 2 C.F.R.
- Rules apply to all "Non-Federal Entities" ("NFEs"):
- Six subparts A through F which are
    - Acronyms and Definitions
    - General Provisions
    - Pre-Federal Award Requirements and Contents of Federal Awards
    - Post Federal Award Requirements
    - Cost Principles
    - Audit Requirements
- Plus 12 Appendices (I-XII) 5 of which are on today's topic but IV is just for you - non-profits

TODAY'S TOPIC: INDIRECT COST RATE AGREEMENTS

- An agreement between you and the WHOLE federal government via your cognizant agency about how you will be reimbursed for certain costs:
  - Binding on Both Parties
  - Contains detailed (kind of) agreement on how to allocate specified costs to final cost objectives using a specified allocation method
  - Don't Ever, Ever forget your proposal is part of the terms and conditions of this "agreement"

Moving On:

The “allowable cost system”

Another Agreement:
Your GRANT (that little thing)

THE GRANT AGREEMENT

- It is not exactly an award of money . . .
- Fundamentally, the grant agreement is an agreement by the federal government to absorb (or pay) certain costs with funds from the federal Treasury.
- Those certain costs are limited by a host of restrictions.

THE GRANT AGREEMENT

- **<u>Basic Restrictions</u>:**
- Parameters of the federally-supported project
  - What you told the agency you would be using the money for in your application "Scope of Project"
    - Narrative
    - Budget
- Time period
  - The "budget period" applied by the agency through the award document
- "Traditional Allowability" concept, that is all costs direct or indirect must be allowable as defined in the cost principles

II. COST ALLOCATION AND INDIRECT COSTS

DIRECT COSTS
VS
INDIRECT COSTS

BASIC DEFINITIONS (2 CFR §§ 200.56, 200.413)

- Direct Costs
  - "those costs that can be identified specifically with a particular final cost objective . . . or that can be directly assigned to such activities relatively easily with a high degree of accuracy. . ." §200.413(a).

- Indirect Costs
  - "those costs incurred for a common or joint purpose benefitting more than one cost objective, and not readily assignable to the cost objectives specifically benefitted, without effort disproportionate to the results achieved. . ." §200.56.

CLASSIFICATION OF COSTS (2 CFR § 200.412)

- **Recipient Discretion:**
  - No universal rule for classifying costs as either Direct or Indirect.
  - A type of cost may be direct with respect to one function, but indirect with respect to another function.

But **Consistent Treatment Required:**

- "... 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 in order to avoid possible double-charging of Federal awards..."

DIRECT CHARGING

DIRECT CHARGING (2 CFR § 200.413)

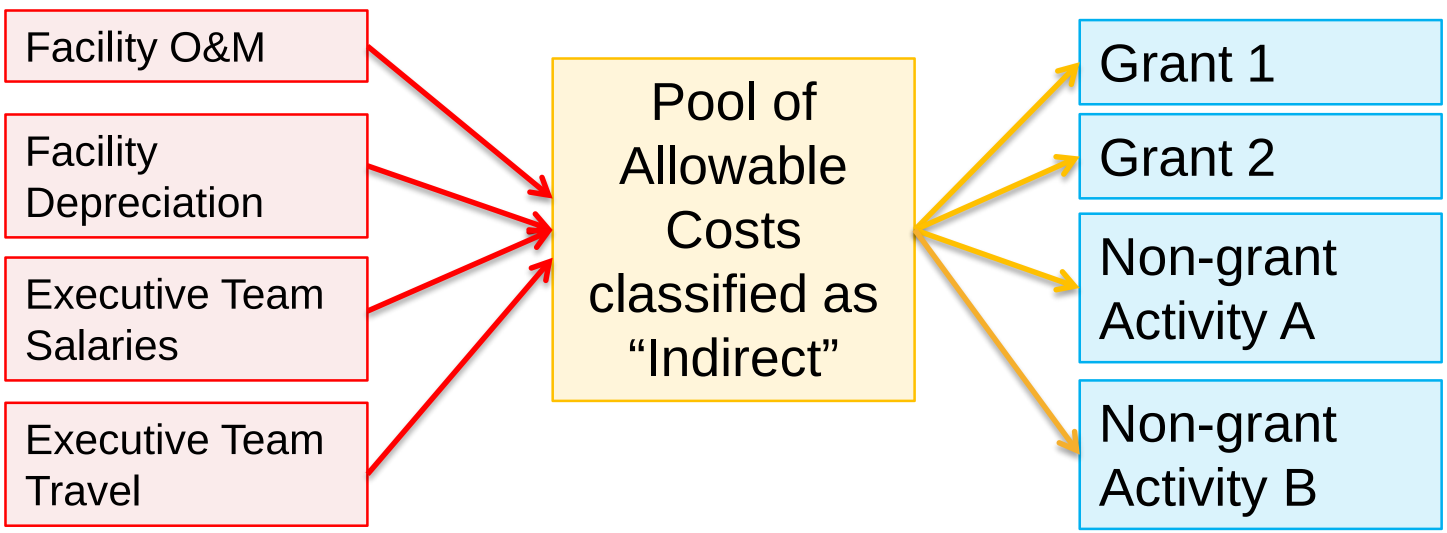
- As recognized by the "direct cost" definition above, some costs benefit multiple cost objectives, but can be easily divided and assigned to those objectives. § 200.413(b).
- Most Common Examples:
  - **Facilities used for multiple cost objectives** – facility costs allocated on a square foot basis by the nature of the use of the space. *E.g.*, In a 10,000 sq ft building, 7,000 sq ft is used for research and 3,000 for instruction.
  - **Employee compensation**, where employees work in furtherance of multiple cost objectives – compensation allocated by percentage of full time spent working on various activities.
    - In fact, this direct charging is formally required by the cost principles through the concept of time and effort reporting. (Recognizing that a secondary indirect allocation may also occur – see below).

INDIRECT ALLOCATION METHODOLOGIES (including direct allocation of **a cost pool** just to get confusing)

BASIC PRINCIPLE

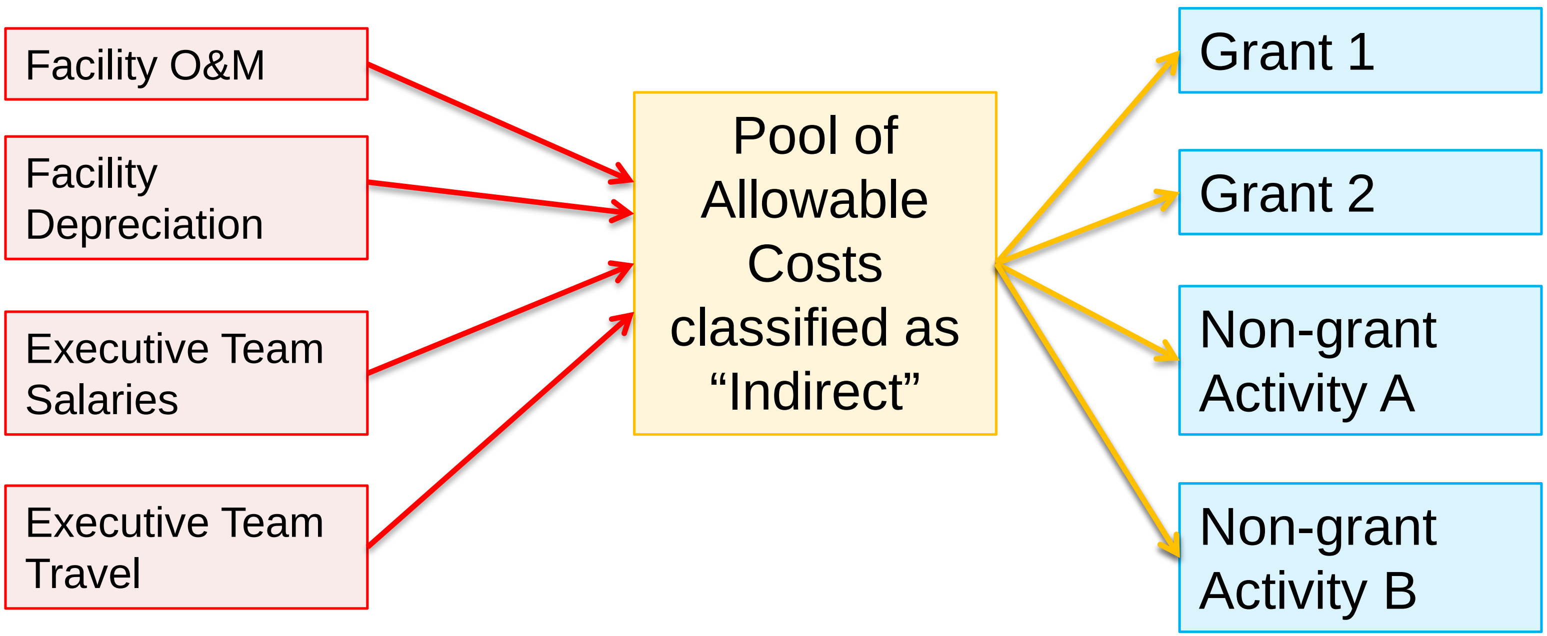
Allocating allowable costs to benefitting cost objectives/functions.

Step 1: Determine treatment as indirect costs is appropriate for the underlying costs.
Step 2: Aggregate those costs into a "pool."
Step 3: Allocate (following certain rules).



SIMPLIFIED ALLOCATION METHOD

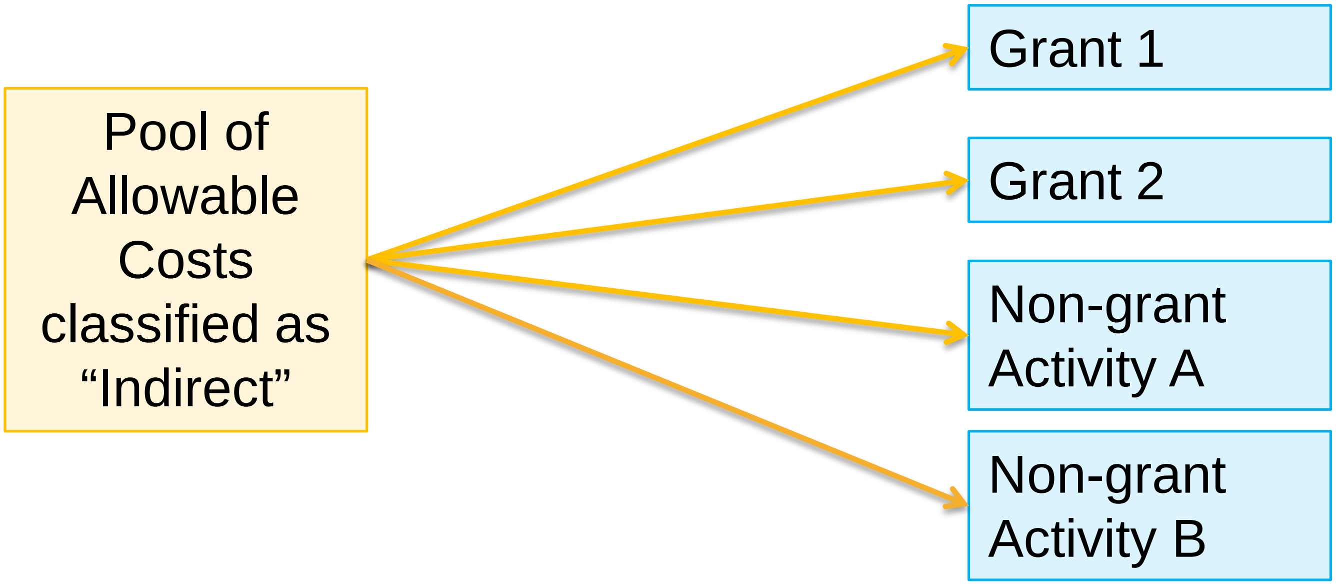
ONLY ONE POOL – STEP 1 (IDENTIFYING WHICH COSTS TO DESIGNATE AS "INDIRECT") AND STEP 3 (ALLOCATING TO AWARDS) ARE THE FOCUS.



SIMPLIFIED ALLOCATION METHOD

STEP 3 IS ALL ABOUT THE BASE:

It must be "an equitable distribution base. . ." which "may be total direct costs (excluding capital expenditures and other distorting items . . .), direct salaries and wages, or [an]other base which results in an equitable distribution. . ." 2 C.F.R. Part 200, Appx. IV, Section B.2.



SIMPLIFIED ALLOCATION METHOD

TO GET TO THE "RATE" (THE PERCENTAGE NUMBER), YOU SIMPLY DIVIDE THE AMOUNT IN THE POOL BY THE AMOUNT IN THE BASE.

$$\frac{\text{Indirect Cost Pool [say \$150k]}}{\text{MTDC (for example) [say \$1 million]}} = 15\ \%\ \text{of MTDC}$$

REMEMBER: The percentage number is meaningless without the base!

WHAT IT MEANS: For every $1 of MTDC you charge to an award, you are entitled to charge $0.15 of indirect costs (the stuff you put in the pool in STEP 1) to that award.

WHAT IS THE DRIVING PRINCIPLE BEHIND SELECTION OF THE BASE?

- Getting back to Fairness!
- "The essential consideration in selecting a method or a base is that it is the one best suited for assigning the pool of costs to cost objectives in accordance with benefits received; a traceable cause and effect relationship; or logic and reason, where neither the cause nor the effect of the relationship is determinable."
- Must be "equitable" to both federal and non-federal functions

MODIFIED TOTAL DIRECT COSTS

- Definitions: Modified Total Direct Cost (MTDC) (new with interim final rule):

- “MTDC means all direct salaries and wages, applicable fringe benefits, materials and supplies, services, travel, and up to the first $25,000 of each subaward (regardless of the period of performance of the subawards under the award). 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 in excess of $25,000. Other items may only be excluded when necessary to avoid a serious inequity in the distribution of indirect costs, and with the approval of the cognizant agency for indirect costs.”

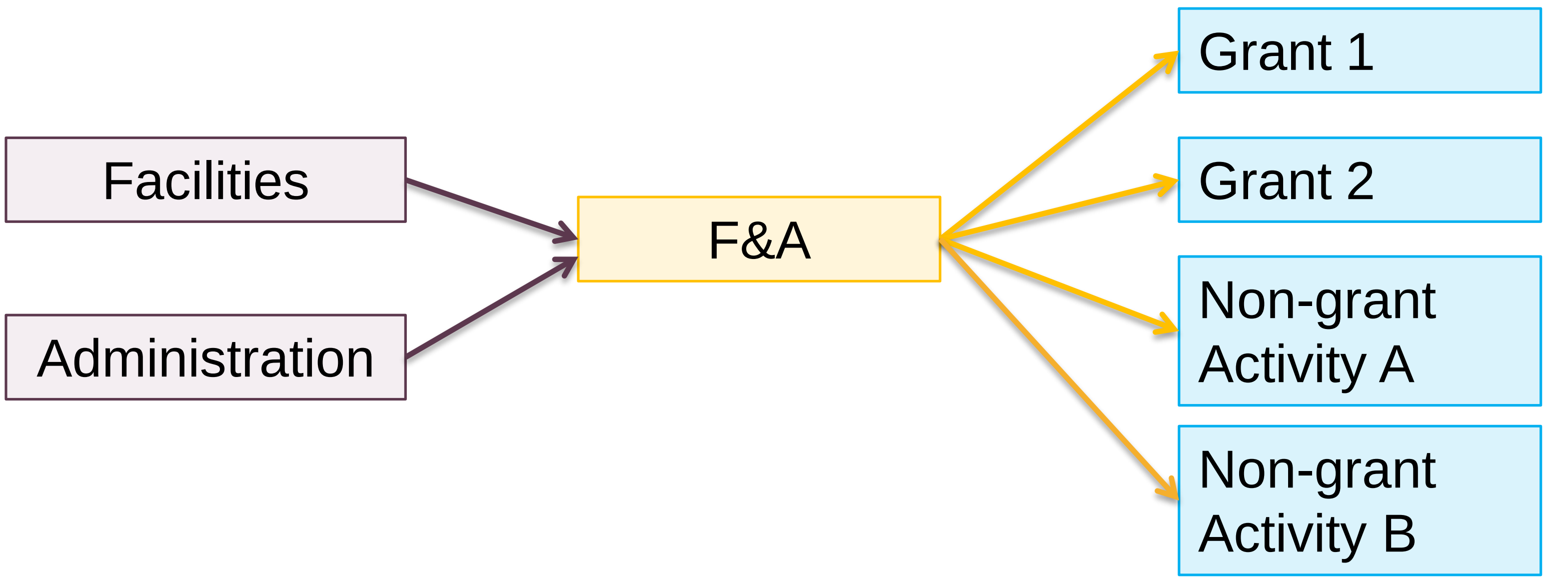
- Note: For Non-profits, other very common base is Direct Labor

Some Additional Thoughts

SIMPLIFIED ALLOCATION METHOD

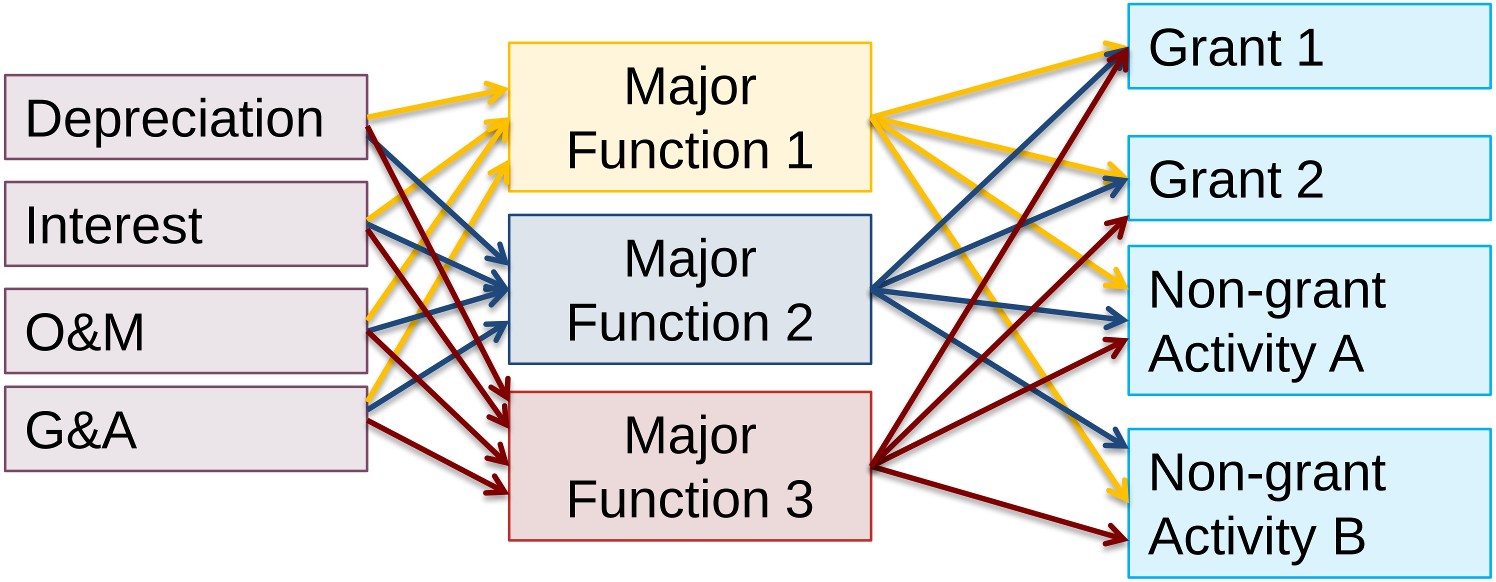
NOTE:

If more than $10 million in direct Federal funding in a fiscal year, must breakout indirect costs into "facilities" and "administration." 2 C.F.R. Part 200, Appx. IV, Section B.2. Two separately identified components of a single F&A rate.



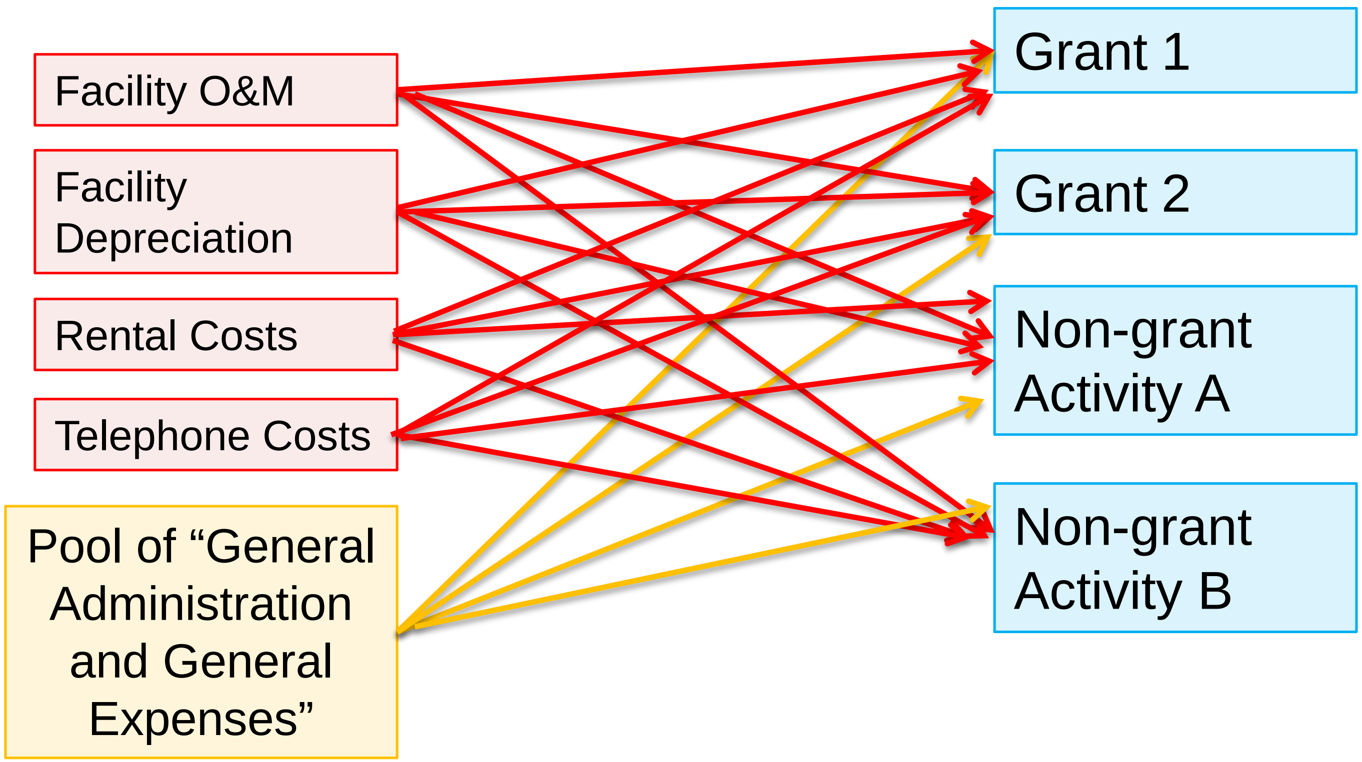
MULTIPLE ALLOCATION BASE METHOD

Basic concept is that the entity has multiple major functions, and first allocates indirect costs to those various functions using certain prescribed allocation bases. Then, those major function cost pools are distributed to the various awards/cost objectives over a MTDC base. You end up with multiple rates (one for each major function). But that's all on this method for today.



“DIRECT ALLOCATION” METHOD (Available for Nonprofits, Appx. IV)

“JOINT COSTS” DIRECTLY CHARGED, AND “GENERAL ADMINISTRATION AND GENERAL EXPENSES” ALLOCATED THROUGH AN INDIRECT COST POOL. OK, SO LONG AS BASE USED FOR EACH “ACCURATELY MEASURES THE BENEFITS PROVIDED TO EACH . . . ACTIVITY.”



FAQS – IRCAS – MANDATORY?

- §200.331-5 Indirect Cost Rates and Entities Who Do Not Have Indirect Costs
  - 2 C.F.R. § 200.210(a)(15), 2 C.F.R. § 200.331(a)(1)(xiii) and (a)(4) all make reference to indirect cost rates as a requirement for recipients and subrecipients. Not all entities charge indirect cost rates. Will they be forced to establish such rates?

ANSWER:

- No. NFEs that are able to allocate and charge 100% of their costs directly may continue to do so. Claiming reimbursement for indirect costs is never mandatory; a NFE may conclude that the amount it would recover thereby would be immaterial and not worth the effort needed to obtain it.
- COFAR, Sept. 9, 2015 FAQs

INDIRECT COST RATE AGREEMENTS

FIRST, WHERE/HOW DO YOU GET AN ICRA?

- "Unless different arrangements are agreed to by the Federal agencies concerned, the Federal agency with the largest dollar value of Federal awards with an organization will be designated as the cognizant agency for indirect costs for the negotiation and approval of the indirect cost rates . . ." Appx. IV, C.2.a. Once cognizance assigned, will not change "unless there is a shift in the dollar volume of the Federal awards to the organization for at least three years. . ." *Id.*

- "previously established indirect cost rates must submit a new indirect cost proposal to the cognizant agency … within six months after the close of each fiscal year." Appx. IV, C.2.c.

- "The results of each negotiation must be formalized in a written agreement between the cognizant agency for indirect costs and the nonprofit organization. . ." Appx. IV, C.2.g.

- "If a dispute arises in a negotiation of an indirect cost rate between the cognizant agency for indirect costs and the nonprofit organization, the dispute must be resolved in accordance with the appeals procedures of the cognizant agency for indirect costs." Appx. IV, C.2.h.

TYPES OF RATES IN AN ICRA

- **Provisional** – a billing rate
- **Final** – final settlement of a provisional rate to actual costs, can result in ADJUSTMENTS
- **Predetermined** – a fixed rate based on actual costs; not subject to adjustment except in "very unusual" circumstances; not supposed to exceed projected "actual" costs
- **Fixed w/ carry forward** – a fixed rate with adjustments in subsequent periods

IMPACT OF INDIRECT ("F&A") RATES UNDER THE U.G.G.

- 2 C.F.R. § 200.414(c) (45 C.F.R. § 75.414(c)) If a grantee has a negotiated indirect cost rate, then all Federal agencies are required to accept it unless there is a statutory, regulatory, or otherwise approved reason for deviation.
- Pass through entities also have to recognize their subs' negotiated indirect cost rates between the sub and the feds if one exists (2 C.F.R. § 200.331(a)(4)) (45 C.F.R. § 75.352(a)(4)) If no ICRA then either PTE either negotiate a rate or apply *de minimis* (at Sub's choice!)

DE MINIMIS RATE
2 C.F.R. § 200.414(f)

- The Uniform Guidance provides that an organization that has never previously had an indirect cost rate, may, instead of negotiating an indirect cost rate, elect to charge a 10% of MTDC "de minimis" rate.

- There is no negotiation with any cognizant agency. The recipient simply elects the 10%, and includes it in its proposed budget. If electing such a rate, it is important that the recipient know what costs are included in its indirect cost pool, and act similarly with respect to all awards.

2 CFR §200.414 ALSO SAYS…

- "…As described in §200.403, costs must be consistently charged as either indirect or direct costs, but may not be double charged or inconsistently charged as both. If chosen, this methodology once elected must be used consistently for all Federal awards until such time as a non-Federal entity chooses to negotiate for a rate, which the non-Federal entity may apply to do at any time."

COMMENTS IN PREAMBLE TO FINAL RULE ON DE MINIMIS…

- “Provide a de minimis indirect cost rate of 10% of MTDC to those non-Federal entities who have never had a negotiated indirect cost rate, thereby eliminating a potential administrative barrier to receiving and effectively implementing Federal financial assistance”
- “automatic rate without any review of actual costs, the rate should remain at . . . conservative levels”
- “concerned that pass-through entities might decline to negotiate, and this would make the de minimis rate more likely a de facto rate for subrecipients.”

FINISHING UP WITH MORE FAQ’s!!

FAQS – LOWER RATE THAN 10%?

- §200.331-6 Pass-through Entities and Indirect Cost Rate Negotiation
  - This section states that pass-through entities are expected to honor a subrecipient's negotiated F&A rate agreement, or use a 10% MTDC de minimis rate, or negotiate an F&A rate with the subrecipient. Is it acceptable to require a subrecipient to accept a rate lower than 10% MTDC via negotiation, or in lieu of their negotiated F&A rate? If a subrecipient requests to establish a rate via negotiation, does the pass-through entity have to establish a rate via negotiation?
  - Answer next slide

ANSWER ON MANDATING LOWER RATES

– If the subrecipient already has a negotiated F&A 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. The cost principles are designed to provide that the Federal awards pay their fair share of the costs recognized under these principles. Pass-through entities may, but are not required, to negotiate a rate with a proposed subrecipient who asks to do so.
– COFAR FAQs, Sept. 9, 2015

Last FAQ – The $64 Question

- §331-7 Indirect Cost Rates and non-Compliance with Guidance

- What should I do if my pass-through entity won't honor my entity's federally negotiated indirect cost rate agreement?

- You may wish to remind your pass-through entity of their obligation under the uniform guidance in part 200.331. As with any instance where a non-Federal entity does not comply with the guidance, the pass-through entity will be vulnerable to any of the measures available in sections 200.338-200.342, Remedies for Non-Compliance, depending on the Federal awarding agencies oversight of their Federal award. The COFAR is working with a Coalition of non-Federal entities to evaluate the effectiveness of implementation and the overall impact of the guidance. For information about where to direct inquiries about the Uniform Guidance in general, please see part 200.108.

FOOD FOR THOUGHT: ADVANTAGES OF AN ICRA POST U.G.G.

- PTEs (like States!) have to follow them now
  - Unless statutory limitation, of course
- Purchases with Indirect dollars exempt from procurement rules
- Cash management tool – payments not specifically associated with costs (at least at first)
- Bid and Proposal costs allowable
- Special Rates, like Fringe Benefit rate, are possible
- Pricing and Budgeting Easier in Multi-funded Environment

DISADVANTAGES OF ICRA

- It is an estimate and is not particularly flexible
  - Not good in times of rapid growth/downsizing
- Negotiating with different offices of your cognizant agency may be difficult
  - Cost Allocation Services (formerly Division of Cost Allocation) at HHS for example
  - Division of Cost Determination at Labor
- Another thing to worry about!

QUESTIONS?

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