Mastering Indirect Costs

It’s Super Complicated...But You Can Do It...Really!
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Definitions

- **Indirect Cost** - a shared cost whose benefit is not readily identifiable with a specific program or programs but is necessary to the general operation of the organization.

- **Indirect Costs** are often referred to as **Overhead costs**.

- **Indirect Cost Pool** – the total of all **Indirect Costs** for a fiscal period.
Definitions Continued...

- **Allocation Cost Base** – basis upon which an entity allocates its overhead costs. An allocation base takes the form of some relevant quantity, such as staff hours worked, mileage driven, or square footage occupied.

- **Modified Total Direct Cost base (MTDC)** - the federally-defined cost base which consists of all direct costs less certain categories of exclusions (modifications) as specified in 2 CFR Section 200.68.

- **Indirect Cost Rate** – a tool for determining the proportion of indirect costs each program should bear. It is the ratio (expressed as a percentage) of the indirect cost pool to the direct cost base.
Common Myths and Pitfalls
MYTH #1

- RCD A's indirect rate is directly comparable to RCD B's
An Indirect Rate can be radically different between RCDs even of the same size. The rate depends solely on type and level of costs that make up an RCD’s indirect cost pool, and the size of that RCD’s allocation base.
MYTH #2

- **Indirect expenses include the same set of costs for all RCDs**
Types of Costs and where to put them

100% direct – Example: Colored paper for a workshop flyer or planting supplies for a restoration project would be a 100% direct cost to that project, as would salaries and fringe or consulting fees for staff who work those programs.

Shared direct costs – Example: Postage or printing costs from RCD office machines, mileage from an RCD vehicle, or a shared cell phone account is a direct cost that can be calculated and shared between programs.

Indirect cost – Example: Project Managers must attend anti-harassment training annually, which is not directly related to one of the projects. Yet without this training, the organization could not operate.
NOTE: Administrative costs could be direct or indirect. Examples include allocation of the accountant’s salary/fringe benefits, the program manager salary/fringe benefits, office rent, utilities, liability insurance, phone, postage, etc. If these types of costs can be identified as benefiting a project directly (and are allowed by the project contract), they can be allocated as a direct cost.
MYTH #3

- **Approved Indirect rates can be arbitrarily applied in order to boost or lower costs to grants**
Once approved, an Indirect Rate must be applied equally across all federal grants so that one grant does not take more of the burden than another.

2 CFR Ch. II App. VII C (3) d. Except where a special indirect cost rate(s) is required in accordance with paragraph (C)(4) of this Appendix, the separate groupings of indirect costs allocated to each major function must be aggregated and treated as a common pool for that function. The costs in the common pool must then be distributed to individual Federal awards included in that function by use of a single indirect cost rate.
MYTH #4

- **Indirect rates are “fixed.”**
A special indirect rate may be allowed if appropriate. This rate is calculated separately.

2 CFR Ch. II App. VII C 4. Special Indirect Cost Rates

a. In some instances, a single indirect cost rate for all activities of a non-Federal entity or for each major function of the agency may not be appropriate. It may not take into account those different factors which may substantially affect the indirect costs applicable to a particular program or group of programs. When a particular Federal award is carried out in an environment which appears to generate a significantly different level of indirect costs, provisions should be made for a separate indirect cost pool applicable to that Federal award. The separate indirect cost pool should be developed during the course of the regular allocation process, and the separate indirect cost rate resulting therefrom should be used, provided that:

(1) The rate differs significantly from the rate which would have been developed under paragraphs (C)(2) and (C)(3) of this Appendix, and (2) the Federal award to which the rate would apply is material in amount.
Pitfall #1

- If a grant allows general expenses to be directly billed, it’s OK to charge overhead also.
BEWARE - If those general expenses were already included in your indirect cost pool, then this is considered “Double Dipping” and not allowed.
Pitfall #2

- Any RCD staff with some bookkeeping background can figure this out.
BEWARE – Both the initial cost allocations and the ensuing calculations can be technical and complex. A person who competently balances the bank statement generates invoices, and pays the bills may not have the technical skills to perform this function.

- Once negotiated, the indirect rate may not be adjusted until the end of the period.
- If unallowed costs were later found to have been included in the rate, repayment of overallocated amounts may be required.
Questions?
Where do I begin?
Federal Code Governing Indirect Rate Calculation for RCDs

2 CFR 200 – Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards

Appendix V and VII to Part 200 - State/Local Government and Indian Tribe-Wide Central Service Cost Allocation Plans
Process to Negotiate Your Indirect Rate

- **Identify your Federal Cognizant Agency**—...the cognizant agency responsible for review and approval is the Federal agency with the largest dollar value of total Federal awards with a governmental unit. Once designated as the cognizant agency for indirect costs, the Federal agency must remain so for a period of five years.

- **Contact Agency for their process**

- **Example: Process for RCDTC and RCDGSD with Forest Service** (see handout)
Questions?
How to Calculate your Indirect Rate
Math stuff

Indirect Cost Pool (numerator) = Indirect Cost Rate %
MTDC Base (denominator)
The Numerator is the sum of all the costs that you have thrown into your indirect cost pool. These are any cost not allocated to a project.

The Numerator contains the costs you assign to it. These costs are not so easy to manipulate; their allocation is fairly cut and dried. In controlling your Indirect Rate, the Numerator is not as important as is the Denominator.
THE MATH CONTINUES...

THE DENOMINATOR

CFR 200 Appx VII allows Local Governments three methods to calculate the denominator:

1. Total modified direct costs (MDTC)
2. Or total salaries and wages, or
3. Another base which results in an equitable distribution
   (RCDTC’s includes 100% of all subcontracts).
Three mathematical examples

The Denominator contains your RCD’s direct costs. In influencing your Indirect Rate, the denominator is where you can try to make decisions in your best interest by selecting the best method and advocating for that method.

Assume RCD Q has an Indirect Cost Pool of $70,000 for this exercise.

RCD Q  Annual Direct Cost Base  $600,000  composed of:

Direct Salaries and Wages  $350,000
Project direct expenditures  $150,000
Direct Consultant subcontract (one contract only)  $100,000
**MTDC Method**

$70,000 Indirect Pool/$525,000* MTDC = 13.33% Indirect Cost rate

*Total $600K less the $75K of the subcontract unallowed = $525,000

This rate can be then allocated to only the costs contained in the MTDC which excludes $75K of RCD Q’s consultant work.
Salaries and Wages Method

$70,000 Indirect Pool/$350,000 Salaries and Wages = 20% Indirect Cost rate

This rate can be then allocated to ONLY direct salaries and wage expenditures.
“Some Other” Method

RCDTC negotiated their 2019 rate to include ALL subcontracts

$70,000 Indirect Pool/$600,000 total direct costs = 12.7%
Indirect Cost rate

This rate can be then allocated to ALL costs included in the denominator, in this case all direct costs
# Three Scenarios for RCD Q using the different Methods

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<th>#1 RCD Q Projected budget for next fiscal year</th>
<th>MTDC</th>
<th>S&amp;W</th>
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<td>Indirect revenue generated</td>
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What is not Allowable?

Can't just leave things out of your denominator - or your numerator – must be consistent:

§ 200.68 Modified Total Direct Cost (MTDC).
MTDC means all direct salaries and wages, applicable fringe benefits, materials and supplies, services, travel, and subawards and subcontracts up to the first $25,000 of each subaward or subcontract (regardless of the period of performance of the subawards and subcontracts under the award). 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.

Expressly unallowable:

Alcohol, bad debt expense, lobbying, scholarships, capital expenditures, tuition reimbursement, participant support costs, etc, and the portion of each subaward and subcontract in excess of $25,000. These have to be taken out of the denominator in all methods (unless negotiated in other)
Questions?
How to Advocate for Yourself

Before you go into it, calculate what you think your rate is going to be. Decide which method will be best by testing each method of calculating the denominator. You could price yourself out of the market if your indirect rate is too high.

Consider what is ahead of your RCD financially so you can advocate and try to influence which of the three methods they use to calculate your indirect.

Your Cognizant Agency has the power to decide how to calculate your indirect, but they likely will listen to you if you can present your case and back it up.
How to Make Up for Lack of Indirect

Why would you have a shortfall in your indirect revenue?

○ High number of state or other grants with capped indirect
○ No tax base to make up for grants with low or no indirect

Solutions

○ Use foregone amount as match (use the difference between your negotiated rate on federal grants that have a cap- some state grants won’t allow)
○ Increase fee-for-service work using billable rates (calculate with a cost allocation plan)
○ Rent District owned equipment to projects
○ Use billable rates on state and other grants if allowed
○ Donations!
Be Careful which Projects You Choose to Pursue

Weigh the potential cost/benefit when choosing projects that won’t cover your full indirect. This can be a hard choice when those projects can be beneficial to your community.
Questions?