The Why, the When, and the How Behind Monitoring Indirect Costs

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Agenda

LEARNING OBJECTIVES

CURRENT FEDERAL FUNDING LANDSCAPE

INDIRECT COST RECOVERY AND ELIGIBILITY

MONITORING

QUESTIONS AND ANSWERS

Learning Objectives

1. Identify sources of indirect cost requirements.
2. Brainstorm risks related to indirect cost rate calculations and application.
3. Identify indirect cost rate proposal submission requirements for state and local governments.
4. Discuss methods to monitor indirect costs.

Current Federal Funding Landscape

Current Federal Funding Landscape

- Each year, the United States Government awards billions of dollars in federal financial assistance to a multitude of entities.
- The objective of these awards is to implement federal programs.
    - Awards under federal financial assistance include grants, cooperative agreements, cost-reimbursement contracts, and more.
    - Each award contains specific terms and conditions specifying rules and requirements to those receiving funds.
    - Award terms specify administrative requirements and program delivery commitments, including those pertaining to reimbursements, reporting, performance objectives, eligibility for program services and participation, and MORE!
    - Funds remain available for the duration of a period of performance – unless the term is modified.

Current Federal Funding Landscape

- Interruptions to award activity is, in a general sense, uncommon.
  - This provides recipients and subrecipients confidence regarding funding availability;
  - Program managers may focus on program delivery and administration; and
  - Risks identified in the grants life cycle remain largely internal to the program or are within the program teams' spheres of influence.
- Now…WELCOME TO 2025!

Current Federal Funding Landscape

- This year, we have observed:
    - Multiple instances in which significant quantities and amounts of Federal awards have been terminated or suspended thus expediting closeouts and other matters;
    - Indirect cost requirements have undergone proposed revisions;
    - Federal courts have intervened in various financial assistance award-related cases; and
    - Uniform Guidance changes from 2024 came into full effect.
- The combination of matters noted above bring about significant UNCERTAINTY.

Pop Quiz #1!

- What is an indirect cost?
  A. Communist
  B. Abad joke that has gone on way too long
  C. Acost that can be easily tied to a specific project(s)
  D. Acost that benefits an organization overall or such a number of projects that it cannot be easily tied to or distributed between activities/projects

Current Federal Funding Landscape

- Uncertainty brings about new or modified risks – including those related to indirect costs.
- To identify indirect cost-related risks in the current environment, recall:
  - Indirect costs include allowable, allocable costs that benefit federal and non-federal award activities;
  - Indirect cost recovery is often a key component of annual organizational budgets as they support critical operating units (e,g., Finance, Legal, and Human Resources);
  - The de minimis indirect cost rate was increased from 10 percent to "up to 15 percent" as of October 1, 2024;
  - Indirect costs follow or are associated with direct costs incurred on a per program basis such that they cannot be front-loaded and are lagging expenses; and
  - Indirect cost rates may not be finalized when needed to timely complete closeout reports that were unanticipated.
- What are some of the risks we may want to consider?

Current Federal Funding Landscape

- Potential risks include:
  - De minimis indirect cost rate either used by ineligible entities or improperly implemented;
  - Potential misappropriation of assets;
  - Contamination of the indirect cost pool;
  - True-up adjustments either not conducted or completed untimely;
  - Increased likelihood of cost misallocation or aggressive accounting decisions to manage potential revenue declines;
  - Third parties also subjected to risk and revenue concerns thus requiring greater monitoring; and
  - Departure of experienced personnel increase risk of noncompliance.

Indirect Cost Recovery and Eligibility

Indirect Cost Recovery and Eligibility

- A number of indirect cost-related risks may be addressed and issues prevented through the rate calculation and negotiation process.
- Three key risks immediately come to mind: eligibility, cost pool integrity, and inconsistent treatment of costs.
- The most common method employed to recover indirect costs is use of a calculated rate assessed against a direct cost base.
- The rate may be:
    - Calculated and presented within an indirect cost rate proposal;
    - Calculated and submitted for negotiation and issuance of a Cost Allocation Plan (CAP); or
    - Application of the de minimis indirect cost rate.

Indirect Cost Recovery and Eligibility

INDIRECT COST RATES ARE TYPICALLY NEGOTIATED BETWEEN RECIPIENTS AND THEIR COGNIZANT AGENCIES FOR INDIRECT COSTS.

STATEWIDE COST ALLOCATION PLANS MUST BE SUBMITTED TO THE DEPARTMENT OF HEALTH & HUMAN SERVICES.

PASS-THROUGH ENTITIES (PTES) ARE RESPONSIBLE FOR NEGOTIATING INDIRECT COST RATES WITH SUBRECIPIENTS, WHEN AND AS APPLICABLE.

Indirect Cost Recovery and Eligibility

- Applicable rate calculation, negotiation, and application guidance continue to be presented in regulatory sections by entity type.
  - Appendices III, IV, V, VI, VII, and IX within the Uniform Guidance present requirements for indirect cost rate proposals (ICRPs) and CAPs for governments, institutions of higher education, and non-profit organizations.
  - Appendix IV requires non-profit organizations without a previous NICRA to submit its initial ICRP within three months of a Federal award (unless the entity elects to use the de minimis indirect cost rate).
  - For each year central service costs are claimed under Federal awards, Appendix V mandates submission of Central Service CAPs by each state and major local government. All other local governments must develop a CAP but are not required to submit for negotiation.

Indirect Cost Recovery and Eligibility

- Appendix VII(D)(1) presents requirements for states, local governments, and Indian Tribal Governments' ICRPs.
    - If a non-Federal entity only receives funds as a subrecipient, the pass-through entities are responsible for negotiating and/or monitoring the subrecipient's indirect costs.
    - "All departments or agencies of the governmental unit desiring to claim indirect costs under Federal awards must prepare an indirect cost rate proposal and related documentation to support those costs."
    - Those receiving more than $35 million in direct Federal funding must submit the ICRP to its cognizant agency for indirect costs.
    - Governments receiving $35 million or less in direct Federal funding mut develop an ICRP and retain it for audit.
- These requirements indicate states, local governments, and Indian Tribal Governments are ineligible to use the de minimis indirect cost rate.

Indirect Cost Recovery and Eligibility

- For-profit organizations are subject to FAR 31.103, which directs commercial entities to indirect cost rate guidance at FAR 42.7.
  - Required data elements are presented at FAR 52.216-7.
  - Agencies may instruct the entities to follow alternative guidance (e.g., agency-specific rules based on the Uniform Guidance).
- The identified sections are the standard sources, but agencies may modify requirements or assert different guidelines.
- Standard terms and conditions as well as statutory provisions in program authorizing legislation may also incorporate indirect cost requirements or restrictions.

Indirect Cost Recovery and Eligibility

- The rate calculation takes the following form, with differences typically based on:
  - Identification of a direct cost base (e.g., MTDC, Direct Salaries & Wages, or Direct Salaries, Wages, and Fringe Benefits);
  - Costs identified for exclusion;
  - Treatment of unallowable costs;
  - Treatment of certain heads of component or non-profit entity-specific cost types;
  - Adjustments to account for audit findings or true-up adjustments; and
  - Agency-specific requirements.

$$\text{Indirect Cost Rate} = \frac{\text{Allowable Indirect Costs}}{\text{Direct Cost Base}}$$

Indirect Cost Recovery and Eligibility

- To apply the indirect cost rate and recovery allowable, allocable costs, we need to know the rate and the base.
- Assume a 25.00% indirect cost rate was approved with a base of application designated as "Direct Salaries & Wages."
  - Organization A incurs the following expenditures in September 2025:

Expenditure Category	Actual Costs Incurred
Personnel	$15,250
Fringe Benefits	3,050
Contractual	30,105
Total Direct Costs	$48,405

  - Indirect Costs = 25.00% * $15,250 = $3,812.50
  - Assume the base is MTDC with no change in the rate. What would the indirect cost expense amount be?

Indirect Cost Recovery and Eligibility

- The de minimis indirect cost rate:
  - Effective October 1, 2024, increased from 10 percent to “up to 15 percent”;
  - May be utilized by recipients and subrecipients without a current negotiated indirect cost rate agreement (NICRA);
  - Must not be applied to cost reimbursement contracts issued directly by the U.S. Government;
  - Must be applied to the modified total direct costs (MTDC) base; and
  - If utilized, it must be applied to all Federal awards until the recipient or subrecipient receives a negotiated rate.

Indirect Cost Recovery and Eligibility

- Recall: the MTDC definition changed effective October 1, 2024. See below from 2 CFR Part 200.1.
- Modified Total Direct Cost (MTDC) means all direct salaries and wages, applicable fringe benefits, materials and supplies, services, travel, and up to the first $50,000 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 $50,000. 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.

Indirect Cost Recovery and Eligibility

- Common errors identified in ICRPs include:
  - Failure to include the Certificate of Indirect Costs or certifications completed by an individual of inadequate seniority;
  - Failure to develop and/or submit an ICRP;
  - Duplication of costs;
  - Inconsistent treatment of costs as both direct and indirect;
  - Ineligible entities using the de minimis indirect cost rate;
  - Inclusion of unallowable costs in the indirect cost pool;
  - ICRP total expenditures do not reconcile to audited financial statements;
  - Misapplication of the rate to an incorrect base during billing; and
  - Inadequately supported subrecipient indirect cost rates.

Pop Quiz #2!

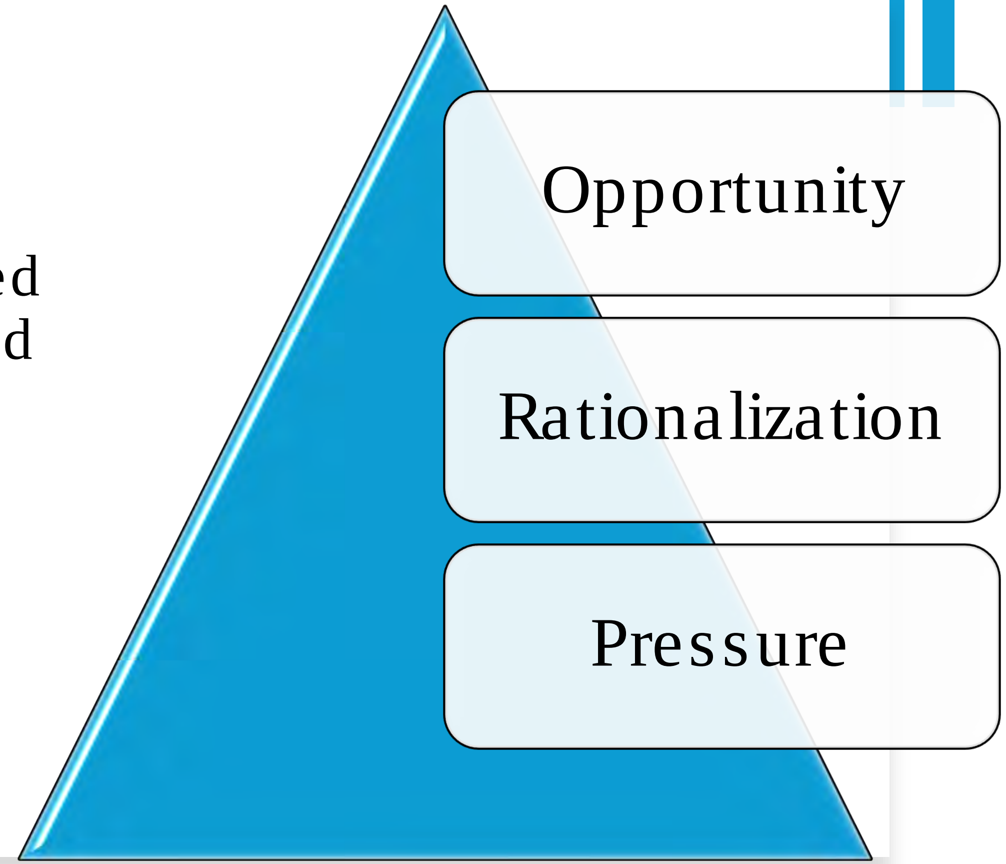
- Whitney and Mariah are a non-profit subrecipient to the Ohio Department of Health under a Federal program titled "Education and Physical Therapy Innovations to Prevent Falls." Whitney and Mariah are a relatively new entity in the federal financial assistance realm. Under ODH, they have a single subaward dated September 15, 2024, valued at $150,000; the subaward budget includes $19,565 in indirect costs based on the 15% de minimis indirect cost rate.

  Whitney and Mariah have two other active awards – both subawards under the Ohio Department of Aging valued at $250,000. For each of the two subawards, an indirect cost rate of 20.25% was negotiated and is accompanied by a base of application of Direct Salaries & Wages. Both subawards are for the same project activities but are being designed and implemented in different regions of the state. The projects are titled: "Connecting the Seasoned with our Youth through REAL Music."

- Question: Are there any compliance concerns or issues to address or consider?

Indirect Cost Recovery and Eligibility

- As one can see from the types of common issues and the risks we previously discussed, there are a number of areas in which someone may make an error.
- Given the current environment, one must be concerned and mindful of financial reporting, noncompliance, and fraud risks.
- Errors will likely be made given complexity, work volume, bandwidth challenges, and levels of experience of subrecipients and contractors.
- Remain vigilant and aware of mandatory disclosure requirements pursuant to 2 CFR Part 200.113.



Monitoring

Monitoring

- Federal agencies, prime recipients, and PTEs are required to conduct monitoring of awards funded and/or issued by the applicable entities.
- Monitoring of subrecipients must include:
  - Oversight of program performance and financial management;
  - Review of audit reports and issuance of management decisions, when required; and
  - Follow-up on corrective action related to audits or monitoring.
- Monitoring of contractors
  - Recipients and subrecipients are responsible for oversight.
  - Must ensure contractors perform in accordance with the terms, conditions, and specifications of their contracts or purchase orders.

Monitoring

- What does monitoring look like?
  - Provision of technical assistance;
  - Desk reviews;
  - On-site reviews;
  - Engaging a certified public accountant (CPA) to conduct an agreed-upon procedures engagement;
  - Conducting standing program status meetings;
  - Requiring, obtaining, reviewing, AND acting upon programmatic performance and financial status reports; and
  - More.

Monitoring

- Given the available options, indirect costs are most often included in monitoring of financial activity and within audit report reviews.
- What would be reviewed as part of indirect cost monitoring for subrecipients?
  - Source documentation supporting the ICRP;
  - Internal control testing, including policy/procedure implementation;
  - Correct application of the indirect cost rate to the identified direct cost base during invoicing;
  - Compliance with program budgets and budget transfer requirements, including budget periods;
  - Corrective action status and closeout;
  - True-up adjustments triggered by provisional-final rates; and
  - Results of subrecipient oversight of their subrecipients and contractors.
- What would be monitored for contractors?

Pop Quiz #3!

- Question: How might your organization go about determining which subrecipients and/or contractors to monitor as part of your indirect cost program?
    A. Risk-based selections after assessing the populations of subrecipients and contractors claiming indirect cost recovery.
    B. Identify those with past indirect cost errors.
    C. Random selection of a set percentage of the population.
    D. Include within standing reviews only and perform nothing on indirect costs specifically.
    E. All of the above
    F. None of the above

Monitoring

- Best practice is to select using a risk-based approach that identifies which entities classify as:
    - Low
    - Moderate
    - High
- Selecting randomly within the categories allows for extrapolation, if needed.
- These selections may be used to do other types of monitoring concurrently (e.g., monitoring Child Nutrition and IDEA at the same time).
- Consider conducting the monitoring exercises early during the fiscal year to allow for technical assistance and timely corrections.

Monitoring

- The risk-based monitoring approach inherently promotes efficiency.
- We periodically must also consider adding selections due to special circumstances, such as terminations and suspensions.
  - What makes terminations and suspensions appropriate for special consideration?
  - How do we go about completing closeout reports when indirect cost rates are still provisional?

Pop Quiz #4!

- Bazinga County's grants for public broadband installation and renewable energy enhancement were terminated due to the projects' no longer meeting the priorities and goals of the presidential administration. The effective date of both award terminations was included on the notices of termination and documented as October 10, 2024. Bazinga County is located in Ohio so its fiscal year ended December 31.
- Due to special circumstances of varying types and numerous in number, Bazinga requested and received an extension for submission of its ICRP to September 30, 2025. The ICRP is now under review.
- The following slide identifies certain transactions that have been questioned during the ICRP review as potentially contaminating the indirect cost pool or being improperly classified.
- Analyze the slide and determine whether you concur with the current status or would suggest a change.

Pop Quiz #4 (Continued)

Trans. #	Transaction Description / Context	Direct / Indirect	Allowable / Unallowable
1	Broadband – 200,000 feet of Fiber Optic Cable ordered in June 2024, received on 10/11/2024, and paid by Broadband on 10/12/2024. Placed into warehouse for general use.	Indirect	Allowable
2	Broadband -$24,789 in project staff salaries and fringe benefits associated with time used to close subawards and complete closeout reports.	Direct	Allowable
3	Renewable Energy – Hytera Video Surveillance software add-on to existing security infrastructure to cover power generation site supporting overall county grid.	Indirect	Allowable
4	Renewable Energy – Allocation of Single Audit fees for FY2024	Direct	Allowable
5	Renewable Energy – Final payments to General Contractor made on February 10, 2025	Direct	Allowable

Pop Quiz #4 Our Final Scenario

- The Buckeye State Department of Education (BSDOE) won a competitive cooperative agreement jointly funded by the U.S. Department of Education (DOE) and U.S. Department of Housing & Urban Development (HUD) valued at $75 million to design, develop, and implement an innovative community-based education model in two rural counties within the state. HUD funds are designated to be managed under CDBG-Entitlement regulations. The first budget period is FY25.
- BSDOE has five subrecipients: Buckeye State Department of Community Development (CD), Weasley County LEA, McGonagall County LEA, Building Community with Community non-profit, and THE Ohio State University's John Glenn College of Public Affairs.
- Program Year and Budget Period 1 has concluded, and DOE's contracted CPA firm has arrived to conduct monitoring of the first period. DOE has classified the award as a restricted rate infrastructure award.
- The monitors have questioned the following key items:
  - All of Weasley's indirect costs due to its use of the de minimis indirect cost rate;
  - All of CD's indirect costs charged due to lack of an agreement between BSDOE and CD, CD's use of the de minimis indirect cost rate, and CD's failure to develop and retain an ICRP for audit; and
  - All of McGonagall's indirect costs due to use of the FY24 restricted rate.
- Do you agree or disagree?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QUESTIONS
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Thank You!

Contact Me

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