Cost Recovery That's Not Over Your Head: The "Ins and Outs" of Indirect Cost Allocation Plans

Presenters:

Allison E. Bradsher, CPA – Controller, City of Raleigh
Nelson Clugston, CPA – Vice President, MAXIMUS Consulting Services
Cherie R. Wright, CPA, CFE, CGFM, CGMA – Partner, Heinfeld, Meech & Co., P.C.
Agenda

- Nelson Clugston:
  - Overview of Indirect Cost Plan
  - OMB Guidance

- Allison Bradsher:
  - Managing Indirect Cost Plan Process

- Cherie R. Wright:
  - Other Uses of Indirect Cost Plans:
    - User Fees
    - Sub-Monitoring
Overview of Indirect Cost Plan

OMB Guidance

NELSON H. CLUGSTON
LEARNING OBJECTIVES

- Cost Allocation Overview
- Types of Cost Allocation Plans
- The Cost Allocation/ICRP Process
- Changes Resulting from the New Supercircular
COST ALLOCATION OVERVIEW

What is Cost Allocation?

Cost Allocation is a Process to Determine the “Total Cost” of a “Cost Objective”

Achieved By Distributing or Apportioning Costs to a Benefiting “Cost Objective”

Using Statistical Data or Metrics that Measure the Usage of a Service or the Relative Benefit Received
What is a Cost Allocation Plan?

A cost allocation plan is the set of documents that relate to the process by which costs are allocated using a set of allocation methods to “benefiting cost objectives.”
Total Costs = Direct + Indirect

Direct Costs
- Usually incurred within the same organization unit
- Can be directly associated with a service

Indirect Costs
- Often incurred within another organization unit
- Cannot easily be associated with the service being costed
- May be centrally budgeted
- Incurred for joint or common purpose
Cost Allocation Components

Local Government

- Departments Serving Departments or "Central Service Departments"
  - Finance
  - Human Resources
  - General Services
  - Info Tech Systems
  - Central Printing
  - Other Central Service Departments
  - Indirect Costs

- Departments Serving the Public or "Grantees"
  - Police/Fire/EMS
  - Public Works
  - Parks
  - Codes Admin
  - Water & Sewer
  - Public Library
  - Social Services
  - Other "Direct" Departments
  - Direct Costs
Allocating Indirect Costs

Allocation Bases: The methodology or statistical measure by which indirect costs are distributed to other benefiting central services and/or final cost objectives. Examples may include:

- Number of active employees
- Number of transactions processed
- Square footage occupied
- Salaries and wages of units supervised
- Direct assignment
Cost Allocation Process

"Central Service" Departments
Allocate to Grantees and Other "Central Service" Departments, as well as to themselves

Allocation Bases
Basic Cost Allocation Guidelines

United States Office of Management and Budget (OMB) 2 CFR Part 225 – Purpose:

Establish principles and standards for determining costs for Federal awards carried out through grants, cost reimbursement contracts, and other agreements with State and Local governments and federally-recognized Indian tribal governments (governmental units)
OMB Regulations Overview

Basic Principle

The principles are designed to provide that Federal awards bear their fair share of cost recognized under these principles except where restricted or prohibited by law. (emphasis added)

Source: 2 CFR Part 225, Appendix A
2 CFR Part 225

Basic guidelines for costs

To be claimed under Federal awards, costs must be:

- Allowable
- Reasonable
- Allocable
Allowable Costs

To be allowable, costs must meet the following general criteria:

- Necessary & reasonable for proper & efficient performance of Federal programs
- Be “allocable” to Federal awards under provisions of this Circular
- Be authorized & not prohibited by state or local laws or regulations
- Conform to limitations imposed by any other Federal FFP regulations

- Be consistent with policies that are uniform for both federally assisted & other activities
- Be accorded consistent costing treatment
- Follow GAAP, unless otherwise prescribed
- Not included as match for another Federal program
- Be net of all applicable credits
Reasonable Costs

A cost is reasonable if it meets the following general criteria:

- Pass prudent person test
- Recognized as ordinary and necessary
- Constitutes sound business practice, including arms length bargaining
- Conform to limitations imposed by any other Federal FFP regulations

- Reasonably related to market price
- Does not significantly deviate from the government unit’s established practices
Allocable Costs

To be allocable, costs must meet the following general criteria:

- Only if benefit is received by Federal program
- All other (non-allowable) activities must receive appropriate allocation of indirect cost
- May not be “shifted” to other Federal programs, except in cases where costs are allowable under two or more awards’ program agreements
- If a joint cost, a cost allocation plan or indirect cost proposal is required as in 2 CFR Part 225
- Ultimately, there must be a relationship between the costs allocated and the benefit derived for that service
Unallowable Cost

- Alcoholic Beverages
- Bad Debts
- Contingencies
- Contributions & Donations
- Entertainment
- Fines & Penalties
- Fundraising & Investment Management
- Legal Services Related to Claims against Federal Government

- Legal Services for Criminal Proceedings
- Lobbying
- Self Assessed Taxes
- Under-recovery of Cost under Federal Agreements
- Idle Facilities
- General Government
TYPES OF COST ALLOCATION PLANS

- Central Service Cost Allocation Plan
- Departmental Cost Allocation Plan
- Indirect Cost Rate Proposal (ICRP)
Central Service Cost Allocation Plan

The documentation prepared by an organization to identify, accumulate, and allocate costs of services provided by a governmental unit on a centralized basis to its departments and agencies. The costs of these services may be allocated or billed to users.

Commonly referred to as a **CAP** for local governments.
Departmental Cost Allocation Plan

The document prepared by an organization unit to identify, accumulate, and allocate indirect costs to the cost objectives defined within the department.

Departmental Plans may be prepared for any department with external funding such as:

- Police
- Public Works
- Parks
- Social Services
- Health
- Planning
Indirect Cost Rate Proposal (ICRP): the documentation prepared by an organization to substantiate its claim for the reimbursement of indirect costs. The proposal is the basis for establishing an indirect cost rate.
Indirect Cost Rate

An Indirect Cost Rate is a Percentage Calculated as follows:

\[
\text{Indirect Cost Rate} \, (\%) = \frac{\text{Total Indirect Costs} = \text{CAP} + \text{Departmental}}{\text{Direct Cost Base}}
\]

The Direct Cost Base is used to distribute indirect costs to individual Federal Awards. An indirect cost rate must be applied to a direct cost base in order to determine the amount of indirect cost.
Types of Indirect Cost Rates

OMB regulations define four (4) types of indirect cost rates:

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<tr>
<th>Rate Type</th>
<th>Description</th>
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</thead>
<tbody>
<tr>
<td>Provisional Rate</td>
<td>A temporary rate, agreed to in advance, based on anticipated future costs. It is subject to retroactive adjustment at a future date after costs are known.</td>
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<tr>
<td>Final Rate</td>
<td>Established after costs are known. It adjusts the Provisional Rate but is administratively burdensome. Underpayments are subject to availability of funds; Overpayments must be credited or returned.</td>
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<td>Fixed Rate</td>
<td>Agreed to in advance and is not retroactively adjusted. Difference between estimated and actual costs is “carried forward” to future years.</td>
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<td>Predetermined Rate</td>
<td>Agreed to in advance but is generally not subject to adjustment. Intended to be permanent; May not be used if an ICRP is not submitted to a cognizant agency.</td>
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Indirect Rate Methodologies

There are two (2) basic methods for calculating Indirect Cost Rates:

- Simplified Method (single indirect rate)
- Multiple Rate Method
The simplified method may be used where each of an Agency’s major functions benefit from its indirect costs to approximately the same degree.

- Reconcile Agency costs to Financial Statements
- Exclude Capital expenditures
- Add allowable non-expenditures costs
- Classify costs as either direct or indirect
- Compute rate for Agency
Simplified Method

Divide the total allowable Indirect costs by an equitable Direct Cost Base (e.g. Salaries & Wages or Total Direct Costs)

\[
\text{Indirect Cost Rate (\%)} = \frac{\text{Total Indirect Costs = CAP + Departmental Direct Cost Base}}{\text{Direct Cost Base}}
\]
Multiple Rate Method

The multiple rate method is more appropriate where each of an Agency’s major programs/divisions benefit from its indirect costs in varying degrees (similar to CAP)

- Classify departmental indirect costs into functional cost groupings (cost pools) which benefit divisions in significantly different proportions
- Select appropriate bases for distribution of each classified pool of indirect costs
- Distribute each classified pool to benefiting divisions
- Calculate an indirect cost rate for each division by relating the total indirect costs allocated to that division to that division’s direct cost base
Selecting Rate Methodology

Consider the following when selecting of the rate methodology:

- Amount and percentage of Federal funding
- Size of the Agency
- Maximizing indirect cost recoveries
- Service variances
- Availability of allocation statistics
- Types of Programs
- Cognizant Federal Agency
COST ALLOCATION PLAN / ICRP PROCESS

Information Requirements:

- Organization Chart
- Chart of Accounts
- Expenditure Detail
- Payroll Data
- Direct Billings
- Interviews
- Statistical Data/Metrics
- Grants Inventory (Schedule of Federal Expenditures)
## Cost Allocation Plan Example

### Schedule .3 - Costs Allocated By Activity

**For Department Financial Svcs**

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<th></th>
<th>Total</th>
<th>General &amp; Admin</th>
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<th>UTILITIES</th>
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* - Indicates Disallowed Expenditure

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Schedule 5.3
Page 42
# Cost Allocation Plan Example

MaxxCars - Cost Allocation Module
08/18/2010 08:25:13 AM

## Schedule 4 - Detail Activity Allocations
For Department Financial Svcs

### Activity - GENL ACCTG

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<tr>
<th>Receiving Department</th>
<th>Allocation Units</th>
<th>Allocation Percentage</th>
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<th>Direct Billed</th>
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Schedule 5.4.1
Page 43
Cost Allocation Plan Example

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<th>Central Service Departments</th>
<th>Social Services</th>
<th>Comm of Rev</th>
<th>Judicial Admin</th>
<th>Sheriff-Courts Sheriff-Law Enforcement</th>
<th>Sheriff-Jail</th>
<th>Other Public Safety</th>
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<td>145,936</td>
<td>247,005</td>
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<td>345,221</td>
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<td>247,005</td>
<td>98,361</td>
<td>345,221</td>
<td>2,723</td>
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Eight Factors to Be Aware of in Supercircular

1. Accomplishes OMB goal of co-locating OMB Circulars into Title 2 of the CFR
2. Focuses on stronger internal control for personal services documentation
3. Sets conditions to limit departures from approved indirect cost rates.
4. Provides for a 10% de minimis indirect cost rate- this may be advantageous for smaller agencies.
5. One time extension of IDC rate for up to 4 years.
6. Sets standard business processes using data definitions
7. Encourages effective, modern operating environment for IT and Shared Services
8. Encourages family-friendly policies
Section 200.414 - Indirect Cost Rates

1. Federal acceptance of approved IDC’s unless an exception is required by regulation, or federal awarding agency approval

2. New de minimis rate - provides for a rate of 10% of MTDC to agencies that have never had a negotiated rate. This rate can be used indefinitely. Agencies must use rate on all awards until they obtain a negotiated rate

3. If the government has a negotiated rate, the section permits a one time extension of rate up to 4 years - subject to review and approval of cognizant agency

4. Negotiated rates must be allowed with pass-through entities
Section 200.430 Compensation of Personal Services and Fringe Benefits

1. No relief for maintaining high standards over internal controls for records used to document salaries charged to federal programs.

2. Charges to federal awards for salaries and wages must be based on records that accurately reflect the work performed.

3. Federal agencies can approve alternative methods of accounting for salaries based on achievement of performance outcomes, including instances where funding from multiple programs is blended to more efficiently achieve a combined outcome.
Section 200.436-Depreciation & 200.449-Interest

1. Must use asset depreciation not use allowance

2. Allows for reimbursement of financing costs associated with patents and computer software - effective date for interest January 1, 2016

3. Capitalization of assets must be in accordance with GAAP
Section 200.466 - Idle Facilities/Capacity

1. Allows for the costs of idle facilities when they occur due to fluctuations in workload – shared services

2. Costs must be reasonable and allocated to all benefiting programs
When Must These Cost Principles be Implemented?

Section 200.110 - Federal agencies must implement the policies and procedures applicable to Federal awards by promulgating a regulation to be effective by December 26, 2014 unless different provisions are required by statute or approved by OMB.

Non-Federal entities wishing to implement entity-wide system changes to comply with the guidance after the effective date will not be penalized for doing so.
Managing Indirect Cost Plan Process

ALLISON E BRADSHER
City of Raleigh

- Capital City of North Carolina
  - 42nd largest City in US

- Provide ‘typical’ government services
  - Public Safety, Parks & Recreation, Water & Sewer, Solid Waste, Convention Center, Public Works

- Employee Base
  - 3,800 Full Time & 3,000 Part Time

- Annual Budget ~ $707M
  - PeopleSoft Financials (Go-Live August ‘09)
Indirect Cost Plan

Outsource Model: Maximus
Primary Focus: Enterprise Funds
Grants Recovery: Limited
Operational Process

- Outsource Process
- Staff Expertise
- Business Changes
- Ownership
- Transparency
- ‘Not Perfect’
- Outsource Partner
City of Raleigh Full Cost

- Central Service Organizations: 31 Discrete Work Efforts
- Operating Organizations: 63 Discrete Work Efforts

Total Cost: $113M
City of Raleigh Full Cost

Work Paper for 31 Discrete work efforts

Use same allocation basis – Ex. FTE

Supported by Queries from ERP System

Invoice Level Detail – Ex. IT Software

User Level Detail – Ex. GIS System
Practice Good Procurement

Write Strong RFP
Include Key Expectations
Best Practice Guidance
3\textsuperscript{rd} Party Extension of You
Staff Expertise

Internal Knowledge
Overall Process
Methodology
Inputs & Outputs
‘3’ Deep Approach
Business Changes

Don’t use SALY  (same as last year)
Understand Central Service Group Operations
Always look for ‘new information’
Strategize with Key Stakeholder
Ownership

Form a team (if possible)

Divides work load and brings expertise

Create an internal PBC (provided by client)

Hold Regular Status Meetings
Transparency

It’s not a ‘black’ hole
Share data early and often
Utilize common drive for workpapers
‘Not Perfect’

Level Set on Expectations

Ensure ‘hard data’ supports your allocations
Outsource Partner

Utilize their Expertise
Discuss ‘best practices’
Include them in meetings
Other Uses of Indirect Cost Allocation Plans

CHERIE R WRIGHT
USER FEES AND CHARGES
Advantages and Benefits

- Generate revenue
- Track user demand
- Control how a service is used
- Carry out public policy
- Fairness
Is a Fee Appropriate?

- Prevent service to non-payers
- Cost of administration
- Payers receive the most benefit
- Customer demand responsive
- Does not counteract public policy goals
Develop Formal Policy on Setting Fees

- How fees will be set
- Stakeholder input
- Frequency of fee studies
- Full-cost recovery vs. subsidy or higher recovery
- Availability to public
Identify Primary Purpose of Fee

Revenue Collection

• Recover full cost
• Recover portion of cost
• Recover cost of additional users

Influence Service

• Discourage waste
• Ration scarce resources
• Carry out policy goals
• Smooth out peak demand
## Determine Full Cost of Services

<table>
<thead>
<tr>
<th>Direct and indirect costs</th>
<th>Indirect costs may be incurred regardless</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Amount of revenue may not justify complexity involved</td>
</tr>
<tr>
<td>Fixed and variable costs</td>
<td>Easier to adjust fees with change in demand</td>
</tr>
<tr>
<td></td>
<td>Works best within limited range</td>
</tr>
<tr>
<td></td>
<td>May be more difficult to estimate</td>
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</table>
Other Factors Influencing Fees

- Market Factors
- Political Factors
- Policy Goals
Periodic Updates

**Full Update**
- Components of costs do not all increase at same rate
- Costs can decrease due to efficiencies
- Processes can change

**Annual Update**
- At least inflationary adjustment
Cautions About Comparisons to Other Entities

What cost recovery policy decisions have they made?

Internal processes may be different

Size of entity can impact internal efficiencies and indirect cost rates

Fees not always charged in the same manner
## Sample Calculation

### Inspection Fee

<table>
<thead>
<tr>
<th>Cost Item</th>
<th>Per Unit</th>
<th>Quantity</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inspection time</td>
<td>$38/hour</td>
<td>1.5 hours</td>
<td>$57.00</td>
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<td>Travel time</td>
<td>$38/hour</td>
<td>0.5 hours</td>
<td>19.00</td>
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<td>Vehicle usage</td>
<td>$6/hour</td>
<td>0.5 hours</td>
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<td>Fuel costs</td>
<td>$3.60/gallon</td>
<td>0.25 gallons</td>
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<td>Report prep time</td>
<td>$22/hour</td>
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<td><strong>Subtotal</strong></td>
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<td><strong>$90.90</strong></td>
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<tr>
<td>Departmental indirect costs</td>
<td>10%</td>
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<td>9.09</td>
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<td>Organizational indirect costs</td>
<td>15%</td>
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<td>13.64</td>
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<tr>
<td><strong>Total</strong></td>
<td></td>
<td></td>
<td><strong>$113.63</strong></td>
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SUBRECIPIENT MONITORING
ICP Review

- Compliance with OMB Circular
- Compliance with Federal agency requirements
- Compliance with grant award
- Compliance with internal policies
OMB A-122

- Facilities and administrative (F&A) cost rates
- Costs are either direct or F&A
- Adjust for unallowable costs
- If no cross-allocation, must follow specified order of distribution
## Indirect Cost Categories

<table>
<thead>
<tr>
<th>Facilities Costs</th>
<th>Administrative Costs</th>
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<tbody>
<tr>
<td>Depreciation and use allowances</td>
<td>General administration and general expenses</td>
</tr>
<tr>
<td>Interest on debt associated with buildings, equipment, and capital improvements</td>
<td>All other expenses not specifically listed</td>
</tr>
<tr>
<td>Operation and maintenance expenses</td>
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Subrecipient’s Submittal

- Indirect cost calculations
- Supporting schedules
- Organizational chart
- Signed certification
- Audited financial statements
Understanding the Entity

- Organizational chart
- ICP narratives
- Audited financial statements
- Form 990 – www.guidestar.org
ICP Detailed Review

- Appropriate allocation method used
- Allocated to all appropriate activities
- Costs categorized appropriately
- Costs allowable and accurate
- Recalculation
ICP Detailed Review

- Appropriate base used
- Consistency in direct costs charged
- Reasonableness of administrative costs
- Comparison to contract/grant documents
- Check with Federal Program Manager
Audit Report Review

- Reconcile amounts
- Any activities omitted from ICP
- Costs categorized appropriately
- Costs allowable and accurate
- Recalculation
It's QUESTION TIME!!

THANK YOU