



CAPLAW Webinar Transcript

Maximizing Understanding of the New De Minimis Rate Part 1

Date: August 6, 2024

Time: 1:00 - 2:15 pm ET

[Jonathan Cohen, CAPLAW]

All right, hi everyone. My name is John Cohen. I'm an attorney with CAPLAW, and I'm welcoming you here to "Maximizing Understanding of the New De Minimis Rate," our first part in a two-part webinar series on some changes to the Uniform Guidance and some changes to, as the title suggests, the new de minimis rate that's allowable.

We are very lucky to be joined by Kay Sohl of Kay Sohl Consulting. She's probably familiar to you all. She's got a host of experience with financial issues, with nonprofit organizations, and with Community Action. We're very lucky to have her here. She's been at our conferences for a number of years and has participated in similar webinars for us. So thank you very much, Kay.

She's going to be doing the bulk of the presenting today and answering your questions. Part 2 is Thursday, August 8, same time, right back here, and that's really where we're going to be answering a lot of those questions that we received from you all beforehand, as well as a lot of them that come into the chat today. So if you do have a question over the course of this presentation, please do enter it into the chat. We'll be keeping track of it and answer what we can today, but probably the bulk of those again will be answered on Thursday. This will also be recorded, so if you miss something and you want to look at it again, we'll try to get that recording up on our website by tomorrow, so people can reference that prior to the Thursday session as well.

But with that said, I'll just turn it over to Kay now. Again, thank you very much, Kay, for being here - and take it away.

[Kay Sohl, Kayl Sohl Consulting]

Okay, well, thank you to Jonathan and the whole CAPLAW team, they have been incredibly helpful as we work through this topic and figured out how we were going to get everything in these two sessions. So I'm very grateful. And they're on board, so if they hear things that seem odd, they're going to comment on them.

So what are we going to do today? Well, we're going to really minimize the review, but I do want to make sure everybody is using terms in the same way. So we're going to go through a little background information on this whole new de minimis rate first. Then we're going to spend a little time talking about administrative costs, because that's really central to what happens with the de minimis rate. And we're going to take a quick review of something you've seen before, that there are four different ways that you can recover your agency-wide administrative costs. We're going to hone in today on the use of the de minimis rate and just the use of indirect rates altogether. And then finally, we're going to

hone in on this increased de minimis rate, and some of the steps you could take to evaluate whether this is a good idea for your Community Action Agency or not.

And then on Thursday, we're going to dive into some of the real problem areas. And many of you sent in questions that really spoke to the heart of the problem areas, things like administrative cost caps and transitioning from one method to another. So we're going to take the deeper dive on that on Thursday.

Okay, so my goal, I told the CAPLAW crew. You know, it's summer, most people are kind of in the dog days of summer. They are exhausted by the heat, but also exhausted by this topic. So my goal is that when you get done with this webinar, you are in a state of bliss, because this is really a kind of a rewarding subject, kind of a brain stimulator. So I hope you enjoy it. I hope you get there. That's always what I'm interested in.

So just the basic background, you know, we first got the Uniform Guidance in 2014 which is 10 years ago, and then it got revised in 2020, and some of you know that one of the difficulties in 2020 was that HHS - Health and Human Services - did not ever adopt the 2020 revisions, and we're going to talk about why that's a problem. But the good news is that the new revisions, the 2024 revisions, we are very hopeful that HHS is going to adopt them, and actually, we're assuming that that's going to be true, because otherwise, a lot of you wouldn't be interested in this de minimis rate.

Now what else are in those 2024 changes? Well, the big one, the change of the de minimis rate from 10% to 15% and, a reiteration that any recipient or subrecipient may choose to use the de minimis rate. Now you can't use the de minimis rate at the same time that you're using a different method, and we're going to talk about that, but you can choose it. There's also some clarification about how do you determine what are direct costs? And there's the other piece of big news that is relevant to this discussion, and that is since the de minimis rate requires the use of a particular indirect cost rate calculation method, the modified total direct cost base method, that's what MTDC stands for. It is important to us that they changed one of the exclusions, and we'll go through what is an exclusion. But they changed it from \$25,000 to \$50,000 so when you're thinking about changes to look at in the 2024 revisions, there are other changes too, but these are the ones that we're going to be focused on.

So what are we looking for? Well I'm waiting for October 1 to roll around so that we can move into the 2024 revisions. And of course, what I'm most interested in is when will we hear from Health and Human Services that they have decided to adopt the 2024 revisions. So now we're going to spend a few minutes just talking about these basic concepts of cost allowability and allocability, because both of them are involved in using the de minimis rate. And some of you have been around so long you know this, you could recite this backwards, that there are cost principles in the Uniform Guidance, and that those principles say that to be allowable, a cost has to have been incurred. That makes sense, you have to have had the cost it. You have to have evidence that whatever you bought or whatever the staff person did was necessary and reasonable, that it wasn't one of the prohibited expenses. And we're going to talk about one of those in particular, and the one that's highlighted in yellow - this is the real problem area. In order to be allowable, you have to be able to associate the cost with the award objective. So whatever the funding is, whether it's Head Start or Weatherization or CSBG, if you're going to charge a cost to it, you have to be able to associate that cost with that set of services that you're being funded for. It sounds simple, but it isn't always easy, and that's this problem of allocability.

So here's how it works. The truth is not every cost can be directly associated with a specific cost objective or cost center. That's because things like, you know, I love the accountants of the world, and we do accounting that benefits every single program and activity in the agency. So trying to figure out

how you would associate the cost of the accounting department with a specific cost objective can be a challenge, and that's really what we're talking about.

Now, those of you who've been around for a while know that in the Uniform Guidance, you the subrecipient are entitled to define cost objective in your system in many different ways. And one of the first choices you have to make is, what way are you going to choose? The common ways are to say it is by program; we're going to set up cost objectives for our programs or for our projects or in Community Action. I see most frequently that people have chosen funding award as the cost objective. And we'll look at how that works in a minute. The truth is, there are costs that benefit more than one cost center, and that we've got to figure out how to allocate or divide estimate the benefit provided to all of those cost centers, and the methods that we use to do that allocation have to be reasonable and cost effective, and you've got to follow them consistently. So a lot of rules here.

Now, with allocability, what we're really focusing on is these costs that benefit more than one cost objective, and the most important thing on this slide is you've got to be consistent. You can't switch back and forth on how you define cost objective.

So let's just take a moment and realize that in this system, we've got different types of costs to worry about, and what we're most worried about is the distinction between direct costs and what the feds have always called indirect – but I think that word is confusing and I'll explain that in a minute. So I actually like to think of these as shared costs and we'll talk about how do we identify them, and how do we share them if they're shared.

So direct costs are the obvious cost, and the example I usually give is if we have the cost of employing a Head Start teacher, and all that teacher does is teach in a Head Start program, that is a direct cost of Head Start, right? In contrast, if we have the accounting department, that's benefitting every program, every grant, so that is a shared cost. And we've got all of our programs and activities in one facility, that's another shared cost. And if we have an IT department that provides IT services for the whole organization, that's another shared cost. So this distinction is actually pretty easy to make. Now, when we find that we've got a shared or common cost that's benefitting multiple objectives, we're going to have to figure out how to estimate the benefit.

The thing that causes the most confusion, is that in common speech, people act like the term administrative costs is the same as the term indirect costs. It isn't, they have two distinct meanings. And while it's true that agency-wide administrative costs are a type of indirect cost, or shared cost, they're not the only type of indirect or shared cost. And making it ever more frustrating, some administrative costs are actually direct costs rather than shared costs. So you can understand why people get confused.

So what we're going to do here is talk about, "well what is an administrative or management cost?" And we're going to remember that once we recognize what it is, and identify it, we can recover it, meaning charge it to our grants, in a lot of different ways. And the big distinction is we might direct charge, and you've gone to webinars and you've read CAPLAW's guide on direct charging costs. Or you might charge it as an indirect cost. But to do that, you've got to have an indirect cost rate, which could be one you negotiated, or could be the de minimus rate.

But the first step is, "well what are administrative or management costs?" and there's some debate on this, and there's actually some differences between different federal programs. But the common concept is its executive oversight, its board support, financial management, and high-level HR or IT

management. Now we're not talking about somebody who touches a computer, and calling them IT management. We're talking about someone who does high-level planning and oversight of an IT system. Those would be your management functions, and we know that when we're talking about the definition of administrative costs, first we figure out, "well which positions are performing these administrative functions, and then we figure out, "well how much of that position was involved in performing administrative functions, because sometimes we have a person who does some administrative functions, and then they do other things too."

For example, an Executive Director – an Executive Director commonly does all of that board support and oversight, and financial oversight, but also in smaller Community Action Agencies, they actually are program experts, and supervise program staff, which is not going to be an agency-wide management function.

Okay, so when we figure out which personnel and what portion of them are going to be in our definition of administrative, we know we have to take not only their salary but their employer-paid taxes and their fringe benefits and we have to take all the other costs that it takes for those people to perform those administrative functions. So, things like facilities and supplies and computers and telephone systems – we've got to get the pro-rated portion of that pertains to these people performing administrative functions. And then we go out and hire contracts, professional service contractors like auditors or consultants on revising our accounting system, and they may be performing administrative functions and we're going to consider them an administrative cost too.

So here's – this bear looks like most people feel like when they think about this, that it can be confusing because these administrative costs, the ones I just listed, they could be direct costs. For example, in programs like Head Start or Weatherization, there is a ton of detailed record keeping that has to be done. And in some Community Action Agencies, a whole position in the accounting department, or a definable portion of a position, is assigned to just that one cost objective. If that's what you've got, if you've got records that this clerk provided accounting work only for Weatherization for the equivalent of half time, then you can charge that. And you should charge it as a direct cost to the program that they provided that to.

The trouble with all these accounting personnel, is we don't want to get into thinking about the person maintaining the general ledger or choosing the financial statements. What portion of their time did they spend on Head Start, as opposed to Weatherization? That is unknowable, and that's why we have these whole systems to get at estimating the benefit that was provided to those different programs or awards. So you know what this comes down to is that administrative functions that benefit only one cost objective, either award or program, you're going to direct charge them. But the ones that benefit all your programs, that's where the challenge comes, because we're going to have to figure out how to charge those to federal awards, and whatever method we use, it's going to be a form of estimating the benefit.

Okay, so now we're down to this – this is kind of the meat of it. What are the cost recovery options to capture the fair share of those agency-wide management costs and other common costs? And this is the basics of what's in the Uniform Guidance. The ones in gold – those are all variations on indirect cost rates. And the Uniform Guidance spells out in great detail how these rates are to be calculated, how you apply to get them, or in the case of the de minimis rate, how you use them if there's a lot of detail about them. The green box direct charging allocated costs is permissible. And you know, when the Uniform Guidance first came out, we had a lot of arguments with state offices about, "well, I read in the Uniform Guidance how to look at these indirect cost rates. You don't have one, you can't charge

your administrative costs.” That’s not true. In the Uniform Guidance, there is a whole provision that deals with, how do we allocate costs so that we are going to direct charge them. In other words, what does that mean? It means we’re going to show on our federal reports that they are direct costs, as opposed to listing them as indirect costs, because it is true, we cannot list indirect cost if we don’t use one of these rates.

So that’s the basic context. And you know, really, each Community Action Agency has a big choice to make. And the choice is, you could decide you’re going to use one of these indirect cost rates – and we’re going to go through them, and how would you use them, and who can use them – or you could decide “I don’t want to do that. I am going to use the direct charging method, and that’s going to mean that I’m going to use cost allocation to justify how I divide up these common costs, including my agency-wide administrative costs.” And we know that CAPLAW just put out a toolkit on this concept of how do you handle direct charging that requires allocation of the agency-wide administrative costs.

So this is the big choice. And what I think is news in the 2024 Uniform Guidance is a lot of us looked at the 10% de minimis rate, which is one of the indirect cost rates, when we first got the Uniform Guidance in 2014 and we said, “not interested. Our agency-wide administrative costs are greater than 10% we don’t want to do that. We’re going to use the direct charging method.” But now that the 2024 revision say it’s 15%, a lot of us are thinking again, including some of us that have already been using an indirect cost rate, but we’ve been using one that we negotiated with a federal agency – we’re going to talk about that situation.

[Jon]

Kay, just a quick clarification question I think. Someone’s asked, “Is this the same method for travel? For instance, attending a Head Start conference? Can you direct charge that? Or is that considered double dipping?”

[Kay]

Well, it depends on what you defined as an indirect cost, because the start of this whole process is you laying out all of your costs and categorizing costs as either going to be recovered as an indirect cost or as a direct cost that has to be allocated. So if you look at people traveling to a Head Start conference, sounds like a potential direct cost to me. Now the question of whether I might have to think of that as an administrative cost because it was the director of the Head Start program that was traveling, that’s a different question. That question has to do with the definition of direct administrative costs, so I think we’ll come back to that, if that’s okay. Does that answer your question, Jonathan?

[Jon]

I think so, yeah.

[Kay]

Okay, all right. So back to this choice that we’re making, whichever way you’re going to go, whether you’re going to direct charge or whether you’re going to use one of these indirect cost rates, you’re going to have to choose, what is your cost objective structure. What are you using? Is it program? Is it award? Is it something else? You’re going to have to identify what you consider to be your agency-wide administrative costs, and you’re actually going to have to turn this into a written cost allocation plan that just spells out that. You know, what are we using as cost objective? What do we consider agency-wide administrative costs? And also, how do we allocate other costs that we don’t consider to be agency-wide administrative costs? We’re going to write it all down, and we’re going to put it in a cost allocation plan, and we’re going to certify. And we were just having an interesting discussion about, “well, is that

confusing?” Because, you know, if I’m using direct charge, we’ve really got to watch this plan, because that’s going to be the basis for defending my direct charges. It’s true, but actually, if you were to apply for an indirect rate, you have to do a cost allocation plan too, and to use the de minimis rate, I think you need to do one too, to be successful and defend it.

So let’s just talk for a moment about what is a cost objective. And this is the citation from the Uniform Guidance and you know, gives you the flexibility to choose what you want to do. And you know, there are two formats that are most commonly used, and you’re going to recognize which one you use, the so-called functional format. We’re all familiar with this because if you look at the 990, it’s organized in a functional format. You’ve got to report your expenses as either management, fundraising, or program. And if you look in your audit, you’ll see that in the schedule of functional expenses too.

So this is an idea where we have all these line items of expense, and we categorize them as being by function. So management is a function, and fundraising is a function. And you may look at those programmatic areas and say, “well, aren’t those awards?” Well, typically, what we’re looking at in Community Action is we might have an early childhood program, but it might have six different awards in it. It might have the primary Head Start, it might have Early Head Start, it might have home based Head Start, it might have state replication of Head Start, but we’ve grouped that all together into an early childhood program.

And the same thing with energy services. We have a LIHEAP program, we might have the water program, we might have utility programs. It’s all related to energy, and we group them by the character of the program, and that gives us the functional definition of cost objective. And it’s different from the funding agreement format for cost objective, where literally, what we are doing is laying out a grid that says, you know, award one or two, all the way up towards award 60, and a lot of Community Action Agencies. And importantly, it includes a category for unrestricted, because it’s pretty much impossible to make the rules work if you don’t have some unrestricted money. And you’ll notice in this format down the second line from the bottom, we have allocated admin costs, and that is to reflect the fact that even if you are using a funding agreement cost center basis, you’re going to have to be able to charge some of your allocated admin costs to each of those funding agreements. And that’s really what we’re going to talk about here, is how do you do that? And would the de minimis rate help you do that?

Okay, so you know, this is what we just said. And I just want to emphasize that you’ve got to have this written cost allocation plan, whether you’re doing direct charging for allocated costs, or you’re using the de minimis rate, or you’re actually negotiating an indirect cost rate. Now, here we go. We’re going to just spend a moment saying, “well, what does it look like if we choose direct allocation?” And you know this is what you’re going to have in your cost allocation plan. And some of you know that CAPLAW has this really incredible cost allocation toolkit for free that you can download and has all the information you need to get a compliant cost allocation plan and cost allocation method for direct charging.

Now, there are some things that are hard, even if you follow the toolkit perfectly. You know, one of them is that there is a rule in the Uniform Guidance for all cost allocation that says you’ve got to allocate the cost to every cost center that benefits – including cost centers that don’t have any federal money, including cost centers where the funder explicitly says, “no, we don’t want to pay any portion of your agency admin costs.” So you’ve got to allocate to all the cost centers that benefit. And this is a tough one when you’re direct charging. In most cases, you can’t propose a method that is essentially the same method that is used in calculating an indirect cost rate, and have that be a justifiable method for direct charging. There are a lot of other methods, and they’re outlined in the CAPLAW toolkit, but that one is generally not allowed.

And what is that method? Well, it's a method that says we're using a percentage of some portion of our cost – direct cost – some portion of our direct costs, and that's what we're really going to be looking at. So if you are direct charging, and you've got a cost allocation plan, as we go through this discussion of indirect cost rates, I think it's going to be helpful to think about, "are we kind of doing something like that, but we've put it in our cost allocation plan and called it a method to direct charge?" You probably need to be aware that you could be challenged on that. Now, you not always are, and I think some auditors just don't want to think about this. So you may have been doing it for years and they haven't said anything. So anyhow, I just that's the truth.

Now this is our classic grid for, "okay, I'm going to direct charge my costs that benefit the whole agency." And in that blue column, you can see I identified these shared or common costs, some examples of them. And on the white part of this chart, program one, two, and three, I put the direct costs. And so, you know, I could look across that line that says total, and I could see, "Well, I've got all those direct costs in those programs, and then I've got \$150,000 of shared cost. And down below is what we're really doing when we have a cost allocation plan, we're following it, and we're going to allocate that rent and the audit and the accounting staff and the utilities. We're going to allocate it using a consistent method to each of the three programs. And then when it's time to charge costs to each of those programs, we're going to take the direct costs and then we're going to add in the allocated costs. So if we look at program three, we went from having \$2 million in direct costs to having \$2,097,500 in total cost when we added the allocated share of shared costs.

So this is the core concept in using allocation to justify direct charging. And you know, it looks simple, but there are some challenges. First of all, you have to find a defensible method, and that's this issue of what is a defensible method for allocating agency-wide administrative costs. Now I'll tell you, nobody really gets stuck on allocating facilities costs or insurance costs or some of the other costs. Nobody wants to argue about them, but people do want to argue about the method that you use to allocate your agency-wide admin costs.

The other problem I've had is that most Community Action Agencies are kind of constantly in flux. We bring in new grants in the middle of the year, we end other grants. Funding sources shrink and grow. It's just constant change in Community Action and when you're using just a cost allocation plan to allocate and charge directly, you're going to be constantly adjusting as all those changes unfold. Another thing that troubles people like me who were English majors, is that when we get done doing this allocation of these shared costs, and we say, those are shared costs, then we turn around and we charge them as direct cost. And it's just troubling. Why would I call something direct when I know it was shared and allocated? Well, you have to. That's the answer to that question. And there's a few costs the Uniform Guidance says you can't even claim at all if you're not using an indirect rate. That doesn't usually bother people. It does in some agencies.

[Jon]

A quick question, Kay, someone said – I think in reference to the chart that you showed – it looks like the direct charging allocation plan is using total funding per source as the way to allocate administrative costs. However, this person didn't think you were allowed to allocate costs based on the amount.

[Kay]

No, you're not. And you know, to tell you the truth, when I created this chart, I don't even remember what I was using as an allocation method, but I know it wouldn't have been that, because that would not be an acceptable method. Good – boy, somebody is good. I'm impressed. I'm impressed. Okay, and then next time around, I think I've got to change that to not make that seem like that's what I did. I hope it's not what I did.

People who've been doing this for a long time. I just have to say as an aside, you know, there used to be guidance for nonprofit accounting. I'm talking really a long time ago, like in the 70s and 80s, and the guidance did say to do that. And so some old-timers are like, "oh, that's what we were told to do." But not anymore, and not for the federal government.

Okay, now we're going to look at these indirect rates, and we're sort of searching for, "hmm, have I maybe been using some of the methods that are supposed to be used for an indirect rate in my cost allocation plan that I'm going to justify direct charging with?" The other reason why we're going to spend time on this is to understand the de minimis rate. This is where it all comes from. This is what the de minimis rate is an example of.

So you know, the really basic concept here is that when we're talking about an indirect cost rate, we're saying, "okay, I've defined what are my indirect costs. What cost am I going to put in the indirect cost pool?" And I'm going to turn that number into the numerator of a fraction, and I'm going to have a denominator that is some kind of direct cost base. And those of us who remember fractions, if I say my numerator is 200 and my denominator is 1,000, that's a 20% rate, that's it. So that's how we go from fraction to percentage. The tough thing here is that the Uniform Guidance provides different choices for what we want to consider to be our direct cost base. Now that's true for the general topic of federally negotiated indirect cost rates, but when we get to the de minimis rate, there is no choice. There is only one acceptable direct cost base, so we're going to look at that.

But a basic rule of indirect cost rates is, you have to do this calculation using all your direct costs, including unallowable costs if you have some, including costs that are funded by sources that won't pay anything towards agency-wide administration, foundation money. Maybe you have a lobbying program that you're funding with unrestricted money. And you know, ordinarily lobbying is not an allowable federal cost. It still has to be in the direct cost base, that doesn't mean you're going to be able to charge it to a federal award. And it is really frustrating to be told that when you calculate your direct cost base, you've got to put everything in there, but you do, and that's how we do it.

Now, the de minimis rate, that's what we're really interested in. And you'll see that big caution sign, just a reminder, if we're talking about today, HHS has not adopted the 2020 revisions. And one of those key revisions in 2020 was the statement that anybody could choose the de minimis rate, and unless they were working under federally negotiated indirect cost rate, in which case they'd have to end that agreement and switch to the de minimis rate. But where the action was, there was a statement in the 2014 Uniform Guidance that said, "hey, if you ever had a federally negotiated indirect cost rate, you can't use the de minimis rate."

Well, it turned out that that caused a lot of trouble, because the federal government doesn't have any records of who used to have a federally negotiated indirect cost rate, or if they do, no one can find them. And so people were really stuck. They would say, well, I think we might have had one, but I don't know." And some people, you know, the bold people, said, "so if I don't know, and they don't know, I'm going to say we didn't, and we're going to use the de minimis rate." But other people knew that they had, and the common thing in Community Action was a Community Action Agency had a Head Start program previously. That's a direct federal award. They had negotiated an indirect cost rate with HHS, and then they lost the Head Start program, and they no longer had a direct federal award. They couldn't renegotiate an indirect cost rate, and they were kind of stuck because no indirect cost rate and no ability to use the de minimis rate because of this provision.

Well, in 2020 the Uniform Guidance said, “No, it doesn’t matter if you used to have an indirect cost rate.” But unfortunately, since HHS didn’t adopt it, they’re still on the “if you had one, you can’t use it.” So cross your fingers. We hope they’re going to adopt it, and then we won’t have this problem anymore. So the key thing, besides worrying about HHS is – and this was a question that came in before this session – no negotiation required. No, you do not have to have it approved. You don’t have to show it to someone in advance. Now, you may have a monitor who comes in and says, “I want to understand what you are recovering through the de minimis rate. So show me your cost allocation plan where you’ve defined what you’re putting in the indirect cost category.” They certainly they can ask, and you should be able to show them, right? But suppose what you show them doesn’t add up to a rate of 10% or 15%, suppose it’s 7%. Well, the rules for the de minimis rate are, that’s fine, you and as Gil Tran from OMB used to say, “what don’t you understand about de minimis? It means at least.” And so when they said it was 10%, that means you can charge 10%. Okay, that seems contrary to what we usually understand about federal costs, but that’s how it is.

The catch on the de minimis rate, whether it’s 10% or 15%, is you can only use one method to define the base, the direct cost base, and that is the modified total direct cost method. And we’re going to talk through that method, because that’s the key issue here.

So, all right, let’s just go over what does the modified total direct cost method for the base mean? So you first have to go through and figure out which direct costs for each of your cost objectives – including your non federal cost objectives – which of your direct costs can you count in the modified total direct cost base? Now, why couldn’t you just say, “well, I know all the direct costs in each of my programs there, I’ll put it in the chart.” Because the modified total direct cost method, what the modification is, is certain costs are excluded from the modified total direct cost base.

So just to flesh out this slide, once we knew what the modified total direct costs were in each of our cost objectives, and that the grand total of all those cost objectives was \$4 million, it’s 10% of \$4 million that would be our allowable indirect costs, and the indirect costs that would need to be charged out to each of our cost centers.

So when we look at the chart a little bit more fleshed out, we start out, if you look over on the green side, you see those modified total direct cost bases in each of the cost objectives adding up to the total modified total direct cost base. And then the white part of the chart is the interesting part. Well, so that first column says unallowable indirect costs. You cannot charge unallowable indirect costs to a federal award. So we’ve got to take care of those in applying the rate. There are costs that are direct costs that are allowable. In other words, a federal award will pay those costs, but the modified total direct cost rules mean that those costs have to be excluded from the calculation of the modified total direct cost rate. And finally, because we’re using the de minimis rate, it’s defined. It’s 10% right now, and we’ll show another slide where we take it to 15%, but in this case, since we had \$4 million in modified total direct costs, then we know that we’re going to have 10% that can be charged as the indirect cost using the de minimis rate.

So let’s get to the heart of the matter. What is it that the modified total direct cost base requires you to exclude from your total direct costs? Well, equipment and capital expenditures. Now you’ll see in the 2024 revisions, they change the equipment threshold to \$10,000, but whatever your threshold is, if it’s equipment, take it out of the modified total direct cost base. Rental costs have to be taken out, can’t count them. Participant support costs. This has caused so much confusion, and our understanding right now is that this means things that you end up buying for your participants so they can participate. And the best example I have is, we’re teaching people how to be carpenters in a workforce program. They have to have steel-toed boots. We’re going to buy those boots for them. That’s a participant support cost.

We don't do patient care in most Community Action. I don't think most of us do tuition remission, but we do make sub-awards. And you know, sub-awards has a whole subject matter. Right now, in the current rules, what you have to do with each sub-award that is part of the direct cost of a cost objective is you have to put the first \$25,000 in that sub-award into the modified total direct cost base, and exclude anything above that and put it in the excluded cost category. That's going to change October 1. It's going to go to \$50,000, the first \$50,000.

Now where people have so much trouble is the last bullet: other costs that would distort the distribution of indirect costs. And this is where we got questions in advance about, well, what does that mean? Does that mean like energy assistance payments? Does it mean rent assistance payments? And the answer is, there isn't really a clear answer, and different organizations look at it differently, and we'll try to explain what difference it would make to you. But I know that a couple people commented in the questions that they were getting different directions from different funding sources, different federal agencies. And you know, I'm sure that's true, and we'll talk about what can you do about it, other than just scream, because the Uniform Guidance was supposed to make things consistent among the federal agencies.

Okay, I do want to make sure everybody understands how you apply the current 10% de minimis rate. And it comes down to this. We start out with those direct costs, the purple section. We know we've got \$400,000. 10% of that is \$40,000 so we take 10% of the modified total direct cost in each of those purple columns, and we write it down as the indirect costs that we are going to charge as indirect costs using the de minimis rate.

Now we've still got some more costs to deal with, and the first one is that \$40,000 that we excluded because it was part of a sub-award and we were following the current rule; we put the first \$25,000 in, and we had to exclude the rest, which, in this case, was \$40,000. Now the important thing to note in program three in that column is that we're not saying that that is somehow an unallowable cost. It's not. It's going to be included in the total cost that can be charged to program three. So just looking at program three, we're going to charge the \$700,000 that was in our modified total direct cost base. We're going to charge the indirect cost using the de minimis rate of \$70,000 then we're going to add back those costs that we excluded from the modified total direct cost base, and the total amount we can charge to that award is going to be \$810,000.

Now, what about the \$10,000 that I showed as unallowable indirect costs? This comes from a real example. I visited a Community Action Agency that had exceedingly high board attendance. And one of their techniques was they always had an open bar for the whole board meeting, and board members could have as much to drink as they wanted on the house. And it was highly effective in getting board members to attend meetings. However, alcohol served in that way is an unallowable cost, and so we can't charge that through the indirect cost rate, and somebody has to pay for it. And the answer to that question is over in the non-federal unrestricted cost centers, they've got to pay for it.

Now let's just take a moment and look at what we're saying about those non-federal awards. We're saying that, "okay, we figured out what the modified total direct costs in them was." And no matter whether their funder said, "we don't pay indirect costs" or not, we have to assign the 10% de minimis rate, \$20,000, and then they have to pick up the tab for our unallowable costs. And that means you got to have \$230,000 dollars available for that. Okay, so that's the crux of the matter in some of the decisions about using the de minimis rate.

Okay, now, how about 15%? You didn't like 10%, would you like 15%? Well, the way you're going to figure this out – and we'll do more of this next time – but the way you're going to figure it out is, first, you're

going to define agency-wide administrative costs. What are they? Then you're going to define your modified total direct cost base. Which cost can you put in the base? Which cost do you have to exclude from that base? Then you're going to do the calculation. You're going to figure out what percentage is that when I put the allowable indirect costs in the numerator and the modified total direct cost in the denominator, what percentage do I get? Is it under 15% or 15%? Well, that sounds good. If you use it, you would fully recover your agency-wide administrative costs. What about if you do it and 15% is more than the actual indirect costs that you think you're going to have? Suppose you calculate it – it's 13%. Well, you have a choice to make then. Now, the Uniform Guidance says you can charge the whole 15%, but my question would be, do you want to, because would you rather maybe charge just the 13% and have that other 2% available for more direct costs in the program?

Or maybe what you would decide to do – if you saw that – is you would look again at how you defined indirect costs, and you might say, “well, there were some other costs that we had, like some costs of our computer system, or other costs that we didn't consider in the indirect category that we could put in there now, and it'll be simpler. We wouldn't be doing so much cost allocation. We could just recover it through the indirect cost rate.” So you could test adding other costs in there. Now the whole concept here is you've got to be very careful about double dipping. You do not want to include a cost in your indirect cost category and then turn around and allocate that cost and direct charge it, because then you're claiming it twice, and that's never okay.

All right. So just to make it obvious, 15%, we did the same thing in this as we did with the 10%. I had to change the numbers, because, remember, if I'm going to charge more to indirect then, I mean there's only so many dollars. That means I have to have fewer dollars going into the direct cost. So while my allowable indirect number went up, my costs that I was calling direct costs in the modified total direct cost base had to go down. So that's something to think about too.

Okay, so now I applied the 15% rate, and really the same thing is happening here as we saw with the 10% rate. I use the 15% to figure out what can I charge to each of my programs. And I've got to charge the 15% to the non-federal, the ones that don't want to pay anything, got to charge them, and they're still getting the alcohol too. So you can see that one of the impacts here is more money being necessary in that non-federal category. Another good impact is maybe we're recovering all of our indirect costs. That would be a really good outcome, right?

Now, you might say, “well, why are you going to talk about federally negotiated indirect cost rates? We're interested in the de minimis rate.” I think it's really helpful to understand more about how these federally negotiated indirect cost rates work, because that is the context for how the de minimis rate works. And if you were one of the groups that when you did that preliminary test on “is 15% enough for us?” and maybe you came up with the answer, “no, it's not, and we have 17% or 18% using the modified total direct cost rate,” then you might want to consider as an alternative, negotiating an indirect cost rate. But of course, you might want to, but you might not be able to, unless you have a direct federal award, because only recipients of direct federal awards can negotiate with the federal agencies.

So if you have Head Start, you could negotiate. If you have another direct federal award you could choose to negotiate. You're supposed to negotiate with the federal agency that provides the largest portion of your direct federal funding. And the first step in this negotiation, is you have to choose an indirect cost base. And then you've got to do this proposal, and we'll talk about that. You're going to submit the proposed rate. There's a bunch of stuff in the Uniform Guidance about how to submit it, what you have to provide. And the federal agency that you are negotiating with is going to make the determination of what rate will they approve, and what time period will it be approved for?

And we're not going to go into a lot of detail about the time period, but I will say that most Community Action Agencies that I have visited, the Federal negotiating agency has given them what is called a provisional rate. Which means "you gave us all this information. We determined that your rate should be 17% or 15% or 25% whatever rate, and we're going to give you that rate for one year." Meaning you may use that rate, you're authorized to use that rate to charge federal awards. But it is only provisional, and that means that at the end of your year, when you have your audit done, you're going to have to submit information about what your actual indirect costs were, and we're going to make a final determination.

And it is possible that if you persuaded us that you should have had an 18% rate, and then it turned out you really had 16%, then it's possible that we're going to say, "well, you overcharged." Now, there's a lot to it. It's complicated. So that's not really what we're talking about today, but it is one of the things you have to keep in mind.

The reason I've put these next slides in is, I do think it really helps to understand the difference among the rate calculations, because it puts the de minimis rate in context, and it sort of explains why it is particularly useful, I would say. So when I first learned about this, I said, "this is really peculiar. Why would they give recipients of federal funds a choice of three different bases to calculate their indirect cost rate?" And honestly, I don't know why they did it, but it's actually helpful.

But it has confused some people in the discussion of the de minimis rate. Because, often in workshops, people will say to me, "well, I don't think a 15% rate would work. Our rate right now is 22% or 23% whether we could never get it." But when I asked the next question, "what base does your rate use?" I'm kind of surprised how many times people say, "I don't know." Well, you do know, you've just kind of forgotten. Because if you look at your indirect cost rate proposal, you'll see which rate you used, and the three choices are – you know, I feel like we need a drum roll here. The three choices are, you could use direct salaries and wages. And some people would say, "well, that's the easiest thing to do, because we run payroll every month. We have a system of recording time and allocating payroll costs to the correct cost objective. It's an easy number to do a calculation with, so we're going to use direct salaries and wages as our base." And when I talk about a base, I'm talking about substituting for where we had in those other slides, the modified total direct cost base. This is a different base. This is the direct salaries and wages based.

The other choice we could make is direct personnel costs. That's where you take the direct salaries plus employer taxes and benefits. And again, people will say, "we like this because it's readily available, every pay period we figure this out." Or finally, you could choose to use the modified total direct cost base to negotiate with the feds. And of course, if you chose that, you wouldn't be bound by the de minimis rules, you might just calculate what your actual indirect cost rate should be using the modified total direct cost.

Now, one of the things you'll notice is that in these three samples that I'm going to show you, there's a difference in what the answer is. And this goes back to fractions. And for those of us who love fractions, you know, this is just like a really fun thing to think about. For people who hated fractions, it's kind of a pain in the neck. Okay, when you use the direct salaries and wages, that's going to be the smallest base, it's going to have the highest indirect cost rate. Total personnel direct personnel costs, well that's in the middle, in between. So it's going to have the middle rate, the 27%, or in our example, the modified total direct cost rate that we got because we weren't using it at minimus, was 22% the lowest of those three rates.

So, you know, I know a lot of Community Action Agencies that have an indirect cost rate have chosen

direct salaries and wages, and their rates are considerably higher than 15% usually. And they may be happy that way, but they may not be happy, and they may be thinking about switching to the de minimis. The people I think are really thinking about switching to the minimum de minimis, are people who currently have a federal indirect cost rate that is less than 15%. Now, why switch? Well, because this process of applying for the provisional rate, submitting the information, getting the final rate, applying for a new provisional rate, it's time consuming, and the federal agencies fall further and further behind all the time. So if you did have an existing indirect cost rate that was 15% or lower, I think you might really want to think about this as just less work.

So, let's look at how these play out. This is the example with the direct salaries. You know, it's the same format. It's just that we don't have to have these exclusions like we do in the modified total direct cost rate. And how does it actually work out? Well, you go through each of your direct cost centers. You figure out what the salaries are that are being charged directly to that cost center. You figure out the other expenses, and it's not all salaries, and you can see what the total cost – what the total direct costs are in each of those cost centers.

And then we get into the indirect costs, and you'll notice that indirect costs, when we're talking about what are indirect costs, they include both salaries, but they include other indirect costs. Because remember when we talked about defining administrative costs, you know, we've got to give people a place to work. We've got to give them a computer. We've got to provide them with IT. So not all administrative costs are going to be salary costs. And what you want to do in this calculation is figure out all your allowable indirect costs. You still can't charge the alcohol. That's still going to be a problem.

So in this example, the direct salaries base was \$2.2 million. They had \$800,000 in indirect costs. That gave them a 36% indirect cost rate using the direct salaries base. And when they applied that, you can see over in that far column, the non-federal direct salaries column, that they're going to have to have, you know, 36% is quite a bit to charge to a program that doesn't want to pay any administrative costs. So they're going to have to come up with quite a bit of extra money to be able to cover that program share of the indirect costs. Because remember, the core concept of the indirect cost rate is a fairness concept. If it's 36% that I'm going to charge to award one, then I'm going to charge it to award two and award three, and to my non-federal awards too. So that's the core concept.

Now this is the middle range, one the total direct personnel costs. What happened here is that it's a bigger number than salaries, and we still have other expenses. And so it goes. In this case, we've still got the \$800,000 in indirect costs. Now we're putting them over a bigger base, because we added those taxes and fringe benefits that brought it down to 27%. And the same thing happened here in using that rate, and we have the same fairness, we had to use it for all of our cost centers, and the same potential problem if we have funding sources that will pay no administrative costs, we've got to come up with some unrestricted money.

Final example in this series, this is an example of how you might choose to use the modified total direct cost rate method, even if you didn't use the de minimis rate. And in this particular example, they had the \$800,000 in allowable indirect and they had \$3.6 million in modified total direct cost, base costs, and that gave them a 22% rate. And so it's the same rules. They would be applying the same rules for what had to be excluded, as we did in the de minimis rate, and this is how it would turn out. And so just like all those other rates, you know, this one was actually 22, 22.2% we're going to apply it to each cost center.

All right. Now I got through in an hour. I can't believe it, Jonathan. I must say.

[Jon]

Yeah. Amazing.

[Kay]

But I just want to preview what we're going to talk about next time. And if we did have questions come in, we might be able to talk them through this time too. So what we have planned for next time is to really do testing for using the de minimis rate for your Community Action Agency, really show how you would do this test. And then, to help you with one of the worst problems, which is that you know, you can understand totally how to calculate the de minimis rate, and you know, be very happy with that. But the fact of the matter is, you probably have some funding sources that have statutory administrative cost caps. And, you know, in Head Start, it's 15%. We got one that in LIHEAP changes from state to state, because the state has some discretion. So what do you do about it? I mean, the Feds just told you, "hey, you can use a 15% de minimis rate to recover indirect costs, but you can't violate a statutory administrative cost cap." So we're going to look at methods that you're going to have to use to deal with that problem.

A big question that we had that came in before this session was transitioning. How do we transition from whatever we're doing now to using the de minimis rate? And we might want to talk about that a little bit to today, if we have time. And then I do think it's worth talking about the pros and cons of actually negotiating an indirect cost rate, if you could, rather than using the de minimis rate. That's a choice to be made. So you know, you're looking at a choice dimension here, of saying, "well, if I have a direct federal award, I really have three choices. I could continue using direct charging," which most Community Action Agencies that I've worked with, do. "I could continue that. I could choose to use the de minimis rate. Or if I have a direct federal award, I could choose to negotiate an indirect cost rate." And so we'll talk about how would you decide, and what are some of the the implementation challenges, which there are going to be implementation challenges because of the timing of the effectiveness of the 15% rate of the 2024 revisions.

So Jonathan, did you get some questions we should try for today? Or should I just do a little talking about the transition to the de minimis rate?

[Jon]

We got a lot of questions. Actually, there was a question about that transition. So if you want to start there.

[Kay]

Why don't we start there? Okay, we saw a lot of those in the questions people sent in advance. Okay, can I transition? Do I have to ask permission to transition? No, you don't need to ask permission to transition, but you do have to be sensible about how you do it. And so we had a question about, "well, is there early adoption?" No, there is no early adoption. I would like to have adopted it last January. No, October 1 is the date. And if you are a program with HHS that used to have an indirect cost rate, if they don't adopt the 2024 changes to Uniform Guidance, you need to pay attention, because some of this isn't going to apply.

Okay? So you didn't have to ask permission, but you do have to wind up whatever you are doing with a current, federally negotiated indirect cost rate. What do I mean? Well, if you get out your indirect cost rate approval letter, you will see that it has a date on it when your provisional rate expires. And while I think it might be possible to sort of notify the Feds that you were quitting before that, I wouldn't do that. I would go through the process of using the rate for the period that the provisional rate is valid.

And I would actually go through the process that you are familiar with of submitting your audit and your calculations to show that the provisional rate was correct, or maybe you have to show that it wasn't correct and getting them to give you a final rate for that – they're looking backwards when they give you that final rate – so for that time period. Why? Because it just wraps it up neatly. And when you have your audit done, it's really clear. What are we auditing on? We're auditing on the Fed's approval of that provisional rate, and that would mean that your transition to use the new de minimis rate would start after the end of the period where you had the federal rate.

Now I think for everyone, I know you could adopt this in the middle of your fiscal year. I just I would be hesitant to adopt it in the middle of a fiscal year. And let me explain why. I think we have two alternatives of how to do this. Let's suppose you are a July 1 to June 30 fiscal year organization, and you're planning that as soon as the Uniform Guidance becomes effective, October 1, you're going to the 15% de minimis rate. Well, I think you kind of have two choices. One would be to do your organization-wide budget – remember, that's an organizational standard, you have to have an organization wide budget. All programs, all costs, all sources have to be shown in that budget.

Do that organization-wide budget for your year that starts July 1, 2024, and ends June 30, 2025. Do it in two segments, the three months before October 1 and the nine months after, and show whatever method you're using right now as the method you're going to use for the first three months. And then show the use of the de minimis rate for the nine months remaining. It can be done. I just think it's a little bit complicated, and the accountants in the group will know too. I really want to make all those adjustments in the middle of the year. I think I would question that.

Now, what about if you're a calendar year organization? I would be pretty interested in saying, "well, I'm not going to do anything on October 1, 2024. I'm going to switch to the de minimis rate on January 1, 2025 and use it for all of that calendar year. That seems simple to me. Then we'll have the audit done on a year that is entirely using the de minimis rate. We can, you know, wrap up our audit of 2024 with whatever method you're using now." So that's probably what I would suggest. But you know your own system best, so you might decide, "well, we're really kind of getting creamed with the method we're using now, and the faster we can switch to the 15% the better it is." Maybe that would lead you to do one of these split year solutions.

Now, do we get other transition questions, Jonathan?

[Jon]

I'll take a look what's come in. Not so much at this time. I think there's some de minimis questions that we can address now.

[Kay]

Yeah, let's do that.

[Jon]

One person asked, "are funding sources allowed to be more strict on what they allow as the de minimis rate? Under the new revisions, perhaps they will only allow 10% not 15%?"

[Kay]

No. No, but that doesn't mean you're not going to argue about it, because, if you'll remember, when we first got the Uniform Guidance, we had a lot of state offices that said, no, you can't use it." Well, you know, who are they? The Uniform Guidance says you can. And we had state offices saying, "oh, but, you

know, you can only use 7% because we have plans for the other.” They can’t do that. They have to follow the rules. And the rules are that, as long as you use it properly, you are entitled to choose to use it.

And the flip side of that – that we had a lot of in the beginning – was, “well we’re requiring you to use the de minimis rate, no more direct charging. The de minimis rate was given to you to make it simple, and you have to use it.” That is not a correct interpretation. And I think now we have probably educated all of the funders that you can’t say that. They can choose to use it if they want to use it. If they don’t want to use it, they can continue direct charging. Now I think we probably will see some funders that try the same thing, that say, “well, my gosh, they raised it to 15% you should just use that and get off this direct charging, which just causes arguments.” Well, no, they can’t require you to use the de minimis rate. If you want to continue direct charging, you can.

[Jon]

And I’ll also say on the on the de minimis rate, the language in the revision says up to 15% and the decision about “up to” is all on, you know, the CAA.

[Kay]

Yeah, it’s on the Community Action Agency. We’re going to talk more about that next time, because suppose you do your calculation, and your true modified total direct cost, indirect cost rate would be 13%. Do you want to go ahead and charge the 15%? You are allowed to if you want to, but I’m not sure that I would want to. Because usually there’s not enough money to cover all the direct program costs that you would like to cover. And if you said we’re just going to charge 13% for the indirect cost rate, that would make that other money available in the programs.

The other reason I would think about it is if you’ve got a sizable number of non-federal programs that won’t honor the de minimis rate. It’s easier to cover a 13% rate than a 15% rate. On the other hand, you know, some people would say, “I’m going to charge the 15% and if it generates a little bit of extra money, good.” I still worry about that extra money, and I still remember Gil Tran saying, “what’s wrong with you? Why don’t you understand what de minimis means?” And I try to keep that in mind, but I do have just a little discomfort about charging 15% when it’s really 13%, but it is permissible.

[Jon]

That gets at another question. If there is that, you know, 15% versus 13%, and there is a surplus of, you know, like these recovers, what can that service surplus be used for?

[Kay]

Well, that’s a good question. I’m not sure I have an answer to that question. I mean, I’ve had people tell me the answer is, “well, that’s unrestricted money because you were entitled to it and you weren’t required to charge any particular cost to it.” It makes me uncomfortable. And this is an old argument that the CPAs of the world, the auditors of the world, had with OMB the first time around. How can you let people charge for costs that don’t exist? Well, so I probably would go back and look at my definition of indirect cost and see whether there was any other shared cost I wanted to put in there to just simplify my system and not worry about it. But I don’t know. CAPLAW, you’re going to have to research whether that difference is unrestricted. I’m pretty hesitant about that.

[Jon]

We’ll look into that. Maybe we’ll do one more question that gets at I think, some of the issues we’re discussing with cost allocation. Can a pass-through entity dictate that a sub-recipient not treat an expense

as partially direct and partially indirect? For example, an Executive Director's salary, but require that it be 100% direct cost? Can a pass-through entity essentially dictate?

[Kay]

That's an interesting question. Well, I think an agency that's trying to do that, what they are actually saying is, "we do not accept the cost allocation method that you have used to allocate that Executive Director salary. And because we don't accept your method, we're going to consider it to be a direct cost." But I would challenge them, direct cost of which program? So I think I might not totally understand that question. If we could ask that questioner to write back in more detail of what they're talking about, I think that'd be a good one for next time, because I'm not sure I understood it correctly.

[Jon]

Okay, yeah, definitely.

[Kay]

Then I think we hit time, didn't we?

[Jon]

We hit time. There are a ton of questions in the chat that we will certainly carry over to the next session, but this was excellent information. Kay, thank you so much for the presentation on this, and we're expecting a lively discussion on Thursday. Hopefully everyone will be back at the same time. The recording and slides will hopefully be up by tomorrow for people to see and reference in preparation for that. And other than that, thanks again for being here and we'll see you all on Thursday.

[Kay]

Yeah, I look forward to it.

[Jon]

All right. Thank you very much.

[Kay]

Bye bye.

[Jon]

Bye.

This resource was developed by Community Action Program Legal Services, Inc. ("CAPLAW") in the performance of an award from the U.S. Department of Health and Human Services (HHS), Administration for Children and Families (ACF), Office of Community Services (OCS), Award Number 90ET0505-01. Any opinion, findings, and conclusions, or recommendations expressed in these materials are those of the author(s) and do not necessarily reflect the views of, nor the endorsement by, OCS/ACF/HHS or the U.S. Government. For more information, please visit the ACF website, Administrative and National Policy Requirements.

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