Maximizing Understanding of the New De Minimis Rate
Part 2

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Time: 1:00 - 2:15 pm ET

[Jonathan Cohen, CAPLAW]
Hello everybody, welcome back. Hopefully you attended our first session. This is "Maximizing Understanding of the New De Minimis Rate, Part Two". Part One was on Tuesday at the same time. The recording for that is available on CAPLAW's website if you missed it, so do check that out.

I am Jon Cohen, an attorney with CAPLAW, and lucky enough to be joined by Kay Sohl of Kay Sohl Consulting again for this second part on this very timely and important issue. Just a few things to talk about before we jump in. One, this is being recorded, so be aware of that. Two, this is hopefully going to be a session that addresses a lot of the questions that we received prior to the webinar series, as well as during Part One - the session on Tuesday. And so we've worked some of those questions into what Kay will be talking about already. But if you do have questions as things come up, please type that into the chat. We do have the ability to unmute you as well. So if you'd like to be unmuted to explain that, please type that into the chat as well, and we'll go ahead and do that. Again, we want to address as many questions and challenges as we've heard about from Community Action Agencies in preparation for this. And so I will turn it over to Kay to get started on doing that.

[Kay Sohl, Kay Sohl Consulting]
Okay, well, thank you, Jonathan. And really thank you to all the participants, because the questions that were sent in have been incredibly helpful in working on this topic. And we are not going to get to all the questions that were sent in. So I just want to reinforce what Jonathan said, that if your question didn't get answered, or maybe this webinar created another one, please type it in, and we will figure out a way to get those questions answered.

Okay, so what we said we were going to do today was that we were really going to tackle how you could test the de minimis rate, particularly the new 15% rate for your Community Action Agency, talk a little bit about the issues of transition, and we got a lot of questions on that. Some of the implementation challenges when you're using the de minimis rate, the whole problem of the modified total direct cost base, which is required in the de minimis rate, and the question of what costs are excluded. And we'll go into more detail on that.

Now this is probably a good time to let anyone who didn't join us on Tuesday know that there is a recording of that Tuesday session. And so if you feel like, "well, wait a minute, I didn't get that," you might want to get the slides and the recording from Tuesday. And finally, we're going to deal with something that probably every one of us hates, which is the issue of administrative cost caps, and how you should think about it, what you can do about it. So we'll get there, and then even more questions.

So let's get started, and this is just to help everyone remember what we're talking about here, which is we all have some agency-wide administrative costs that we need to be able to charge to our federal awards, and the Uniform Grants Guidance gives us really four possible ways to do that. The three that are in gold on this slide are variations of an indirect cost rate, and they include the de minimis rate. So that's a whole methodology. The other box is green because it is a totally different methodology. It is not an indirect cost rate. It is something that CAPLAW has a guidebook on. It's the issue of, how would you use cost allocation to direct charge allocated agency-wide administrative costs? So that's the context. And so we're going to hone in today on what happens when you try to use the de minimis rate, which is one of the ways to get an indirect rate.

So essentially, as you're thinking about what you want to do, you are making a very big choice. Do we want to use an indirect cost rate? Or would we prefer doing what many of us have been doing for a long time, which is getting a cost allocation plan and using it to allocate administrative and other shared cost and then direct charge them. We know that if we answer, "we want the indirect cost rate," that's going to mean that we have to follow a set of rules about how to compute that indirect cost rate, and those rules are applying to the de minimis rate too. So we're going to have to go over those rules and look at some of the gray areas on those rules for turning your allocated cost system into an indirect cost rate system.

So I think a question that a lot of Community Action Agencies are asking themselves right now is, should we consider using this 15% de minimis rate? And let me just remind you that up until October 1, 2024 the de minimis rate has been set at 10%. A lot of Community Action Agencies said, "that is not enough to cover our administrative and other common costs. We're not interested in 10%, but now that it's 15% we are thinking about it." And so what we want to talk about is, how could you tell whether this would be a good path for your Community Action Agency?

So what it comes down to is you're going to have to set up a spreadsheet and actually test what your true indirect costs are as a percentage of the modified total direct cost base, and we're going to be defining that term. What is it? And so we'll learn how to do this calculation. You'll do the calculation, and the question you're going to ask yourself is, well, what answer did I get? What rate did I get? If I got a rate that's way over 15%, this probably isn't going to work. If I got a rate that's under 15%, it might be a really good idea.

So the first step in doing this is actually looking at the direct costs in each of your cost centers. And as we said on Tuesday, you have a choice in how you define cost center. You could define it as each award, you could define it as each program. But however you defined it, you need to determine what the direct costs are for that cost center, and then exclude the cost that you're required to exclude.

The next thing you've got to do is review what you said in your cost allocation plan about how you define agency-wide administrative cost and direct administrative costs. Now we talked last time about the fact that, yes, administrative costs could be either agency-wide and they would be part of your indirect cost, or they might be direct cost, because you – a good example – you hired someone whose entire job involves doing accounting in the Energy Assistance Program. So that could be, it's administrative because they're doing accounting, but it is a direct program cost because it's entirely one cost objective, rather than benefiting the whole agency.

Next thing you've got to do is look at all your funding agreements and determine whether any of them have a statutory admin cap. Now what that means is that when the statute establishing that funding source was passed, they put a cap on how much administrative costs could be charged. And we're going to talk quite a bit about that today, but just the sort of teaser is that, remember, administrative cost is not equal to indirect costs. Sometimes it's the same thing, sometimes it's not so we're going to have to get into the definitions there.

Well once you've done those first three steps, you can actually calculate what your indirect cost rate is using the modified total direct cost method. And you know the question you're going to ask is, "well, if it's more than 15% if we start using that, we're not going to be able to recover all of our agency-wide admin cost. It's less than 15% we would be able to recover them, and we might be able to recover some other shared cost as well through the indirect cost rate."

So this whole slide deck is laced with questions that people sent in. And so this one was about charging the consistency in charging the de minimis rate. We just talked about how you would compute it. Now, how are you actually going to use it? And so the question was, ***if we charge the full 15% de minimis rate to some of our awards, do we have to actually charge it to all of our awards?*** And the answer is, you have to be consistent in how you charge the indirect cost rate within your accounting system. So if you envision all your cost centers set up in your accounting system, and you're now going to make – you're going to record an indirect charge using the rate. You're going to put 15% of the modified total direct cost base of each of those cost objectives. You're going to record that as a cost of that cost center.

But that is not the same thing as what you decide to actually request payment on from your federal award. If you wanted to, you could say, "well, in this particular award, I have so much need for money for the direct cost that I don't want to charge 15%, I want to charge 10% and I want to take that extra 5% and use it for more direct costs for this thing." You could do that, but you would have to show that you had some unrestricted source that was going to pay the difference, that was going to fully cover the 15%. So when you start thinking about doing that, I think, "well, if I've got that unrestricted money, why wouldn't I just spend it on the direct cost and just have a simpler system for using the 15% de minimis rate?"

Now the next question we got was about identifying the indirect costs. What are we putting in that category? Because remember, you need to have documentation in your cost allocation plan that tells anybody who wants to know, "what costs are we putting into this indirect category that we're going to recover by charging the de minimis rate?" So in this example, they told us that the controller keeps very good time records, such good records that she or he is able to actually define how they spent 75% of their time in terms of "I spent this much on award one and that much on award two, and they're on award three." So they actually can turn 75% of the cost of this controller into direct cost, direct charges to those awards. But there's still 25% of their time that it really is not feasible to determine what program or cost objective was benefited, and that's what they've put in the indirect cost pool.

And so their question was, can we treat that 25% the costs that come from that as indirect costs, and recover it through charging the de minimis rate to all the cost centers? Absolutely, any cost that you put into the indirect cost category, you are going to recover by charging the indirect cost rate, in this case, the de minimis rate. Someone might someday be like me and say, "do they really know how they spend 75% of their time?" But that's a question for another day.

Okay, now we got another question. Do we need to charge indirect costs on fundraising expenses? And you know, in the examples we gave last time, we didn't talk about fundraising expenses. But you know, most federal awards do not permit fundraising expenses. They're not allowable expenses. So that means that those fundraising expenses have to be put in a different cost center, a cost center that isn't going to be paid for with federal dollars. But because the requirement for using the de minimis rate is that you apply it to all your cost centers, yes, you would have to apply it to that cost center where you put those fundraising expenses. And you would have to be able to show that you were able to pay for it, that 15%, with unrestricted funds. So yep, you got to do that.

Now, this is the beginning of a reminder about how this modified total direct cost base works. The thing that makes it potentially confusing, you know, everybody can understand the concept of what are the direct costs of an award or a program. You know, those are costs that I can directly attribute to that work that we're doing under that funding agreement. But that's not the cost base we need. We need those costs after excluding certain costs that the modified total direct cost rate method requires to be excluded, and those include any cost for equipment or capital expenditures, any costs for rent. And I had a question about that. That's like, "you know, do you pay rent for Your Head Start centers?" Well, that's rent. So that would be excluded.

Participant support costs. This is commonly misunderstood to mean all the kinds of energy assistance and grant assistance that we give out. That is not what participant support costs are. It's much more specific. This is about participants in your program. Do they have to have certain things provided for them in order to participate? And my most concrete example were teaching people to be carpenters, they have to have steel toed boots. We could provide those steel toed boots, and that would be a participant support cost.

We're not going to talk about patient care and tuition remission. That's not big in Community Action, but it is important to recognize that there is an exclusion that has to do when you the Community Action Agency are making sub-awards, and you have sub-recipients. And right now, under the old de minimis rules, you must exclude all but the first $25,000 in each of those sub awards. When we move to the revised Uniform Guidance on October 1, 2024, that is going to change to being you get to include the first $50,000 of each sub award in your modified total direct cost base.

But it's really this last bullet that causes the most frustration, and that is the bullet about other costs that would distort the distribution of indirect costs. And this is where we actually have some disagreements about "what does that mean?" And probably the one that we're going to talk about the most is, "well, what about when I am paying for direct assistance for my clients, like I'm giving them rent assistance or utility assistance, or other emergency assistance? Is that an example?" Because it's usually a large chunk of money that we are paying out for utilities, for example. So is that one of these costs we have to exclude? Well, we're going to keep going and talk about that.

So you know something to remember before you start trying to figure out whether you think you want to exclude the rent assistance and utility assistance, is once you exclude something from the modified total direct cost base, you can't charge the indirect cost rate on it. So if I exclude $3 million in energy assistance payment, and I'm using the 15% de minimis rate, I can't charge that 15% to that $3 million. So you can see what the problem is here. And some would argue, "well, wait a minute, I have a lot of administrative burden that is related to dispersing those utility payments, I want to charge it." And so you're going to make the argument that this cost doesn't distort the distribution of indirect costs. Okay?

And here's another really frustrating thing, and we heard about this in the questions, different federal agencies will tell you different things about these types of costs that they think must be excluded. And

I believe that if they've told you that definitively, you must exclude this cost from your modified total direct cost base, you're going to have to do that for that cost center, for that award. You don't have to apply their rule to your other awards, but you do have to follow their rules, unless you can persuade them they're wrong.

So you're going to follow whatever – you know in a lot of federal programs don't give you any specific guidance. They say that's why we got the Uniform Guidance. That's why we have the de minimis rate. That's supposed to give you uniform direction. Other funding sources, and sometimes this actually comes from pass-through entities, just want to put their hand in there and tell you what they think, and you know, you've got to decide, how hard are you going to fight over what they think?

Okay, so now we're on to some interesting questions. ***These folks purchased a bus for $200,000, and they understand that they have to exclude that, because that's a piece of equipment, right? That can't be in the modified total direct cost base. But they said, do we still get to apply the 10% indirect rate?*** They're using the old de minimis rate to the bus purchase. No, once a cost is excluded from the modified total direct cost base, you don't apply the indirect rate to it. You only apply the indirect rate to the costs that are in the modified total direct cost base.

So, this was a follow-up. ***If equipment is excluded from the modified total direct cost base in the year of the purchase, in subsequent years can we include depreciation expense on that equipment in the modified total direct cost base?*** Well, the starting point here is, if you use federal dollars to purchase this equipment, you can't charge depreciation on it to a federal award, right? That would be double dipping. So that would be a starting point. However, a lot of us follow gap accounting, and gap accounting says that it doesn't matter who paid for something, you own it, and you should record depreciation. And so we are recording depreciation expense, it's just that we're not charging it to a federal award, we've put it into one of these unrestricted cost centers. So if you did that, if you had put that depreciation into an unrestricted cost center. Yes, you would have to follow the rule that unless it is excluded from that cost center, you have to apply the indirect cost rate to it. And you know, for some of us, that's not a desirable outcome, because it ups the amount of unrestricted money we have to have, not just the direct cost but the indirect cost rate. We've got to show that we have other funds to pay that.

And now we've got another one. Here's the heart of the matter. ***Are direct benefits for clients, like energy assistance or rental assistance, excluded from the modified total direct cost base?*** And I have to say, when I look at what Community Action Agencies are doing, I see it handled both ways. Some do include those energy payments or rental payments in the modified total direct cost base. Others exclude them. You know, you're going to have to decide what you believe is fair for your organization. When you think about the administrative burden, not of running the whole program, because remember, you're already being paid for the stuff that are going to, you know, screen eligibility and the other components of this program here. We're really talking about the cost of processing all those payments that you have to send out. If you believe that that should get an indirect cost rate allocation, you're going to include it in the base. If you believe that it's quite different than the other things that have been included in the base, you're not going to include it now. I mean, that's really frustrating answer.

And you know, I think the next question someone asked, "well, you know, who could I talk to to know whether what I'm doing is right or not?" And you know, the whole thing about this model, this de minimis rate, is we're not supposed to have to talk to anybody about it. It's supposed to be so clear that we can just straight out use it. If I were struggling with this, I probably would talk to my independent auditor and get their opinion on this question, and consider it. You know they're going to tell you, "we don't make your decisions for you. It's you who makes the decision." But it might be a clarifying conversation.

We had a lot of questions on, ***I'm interested in this 15%. How would I transition to use it if I haven't been using the de minimis rate before, or even if I have been using it, but I've been using the 10%?*** So, you know, here's the basic idea. I would say it's a lot easier if you wait until the beginning of your fiscal year, that is the fiscal year after October 1, 2024, and do the change then. And a question we got asked a lot was, ***well, but wait right now I have a negotiated indirect cost rate. Can I just dump it and switch to the de minimis rate?*** And the answer is, you're going to have to wrap up your negotiated indirect cost rate. And in general, the easiest way to do that is to wait. Most of us are on a provisional, final system with indirect cost rates. Wait until the end of your provisional rate period, the end of the year, when you would ordinarily be getting your audit done and sending in your report to your cognizant agency that you negotiated this cost rate with, and you would be proving to them either that the rate was correct, or you might be showing them that your actual indirect cost rate work was higher, or you might show them as lower. But you know that what they're going to do at the end of that, is they're going to issue a final rate, and at that point, that is where you are going to say, that's the end. We're not having a negotiated rate anymore. I'm not asking for a provisional rate for the coming year. I'm going to be using the de minimis rate. I suppose you could explore terminating your rate agreement earlier. The problem is you still would have that report due that needs audited financial statements. I just think you would be making life complicated to do that.

Okay, what about if I like the de minimis rate concept, but I don't think that our costs really are 15% and I don't want to charge 15%, not so much because I'm worried that that I might have a problem if I didn't have enough cost for 15%? Remember that the rule of the de minimis rate is you don't have to prove the cost. But I think the reason why you might want to charge less than the 15%, is that you might prefer to have some more dollars available for direct costs and not spend them in indirect costs.

So, you are free to charge less than 15% and still be using the de minimis rate. So maybe you decide 12% is a better rate for you. You can still charge that as an example of your using the de minimis rate. And why does that matter that you label it the de minimis rate? Well, because if you just wanted to charge a 12% modified total direct cost rate without invoking the de minimis rate, you'd have to go through the negotiation process to get a negotiated rate. And some of us can't do that because we don't have a direct federal grant, and only those who have a direct federal award can negotiate an indirect cost rate.

So you know, again, going back to steps, what are we going to do here? I would say your first step is to calculate what is your actual indirect cost rate using the modified total direct cost base. So to do that, you've got to make your decisions about what's excluded and what's not excluded. Once you know that rate, then you might have a problem. You might discover, by doing that, that your actual indirect cost rate is 17% or 18% and you would know that if I charge the 15% de minimis rate, I am not going to be able to charge my federal awards for my full indirect costs, and I'm going to have to cover them some other way.

So what could you do about it? If that's what your calculation showed? Well, one idea would be to look again at your definition of which costs you were going to recover through the indirect cost rate or the indirect cost pool, and see whether you have some costs in there that are not agency-wide admin costs, but are other shared costs that you thought, “well, you know, it'd be easier to recover this shared cost through the indirect cost rate.” Maybe you put in some costs of leasing a copier, or – that's probably not a great example – some costs related to managing supplies in your whole system. But they're not actually administrative costs you put something – or how about your janitor? You've got a janitor who's cleaning a whole facility, and you know, you've got all these different programs and managers in there. Well, it would be easier to recover through the indirect cost rate, but your cost rate turned out to be more than 15% so try pulling that janitor out of there and using your cost allocation plan to decide how you're going to allocate the cost of janitorial services. But through allocation, you're going to direct charge it. You're not going to recover it through the indirect cost rate. And what you've done there is reduce your indirect costs to get them closer to what you can recover with the de minimis rate.

Now another approach would be to say, “I don't want to fool around with it. It's so much easier to put those costs that benefit everything into the indirect cost pool, I'm just going to accept that 15% isn't enough, and I'm going to use unrestricted funds to subsidize all of my programs where I'm not recovering my full indirect costs.” So we got this question about transition. The person said, ***we have a negotiated rate. It's 6% and we want to switch to the de minimis rate. Do we need to use 15% as our de minimis rate? Or could we use the 6% but declare it to be through the de minimis rate requirements?*** Well, you can choose to use those de minimis rate provisions and claim a rate lower than 15% so yes, you could do that. This might be a time saving strategy. I think that's probably why they're interested in it. Time saving, meaning, when you negotiate an indirect cost rate, you're in this cycle of submitting a proposal for a provisional rate, submitting the information about what actually happened, getting a final rate, proposing a new rate for the next year. It just goes on and on. And so you would just be done with that and simply say, I have a de minimis rate and here it is. My question to this questioner: are you sure 6% using the modified total direct cost rate is going to recover your full indirect costs? That's pretty low, so I would just check it out to be sure.

Okay, we got another question that said, ***if you use the 10% de minimis now, and you're a July through June fiscal year organization, can you still change to the 15% rate in October? Or should you wait till your next fiscal year, July 2025 to use the 15%?*** Well, that's a complicated question, okay? Although it's not totally explicit in the revisions, we believe – CAPLAW and I believe – that we know that the de minimis rate at 15% is going to be available for awards that begin October 1, 2024, and then on. We don't think it's going to be available to go retroactively to the awards that you already have in place, and when we get to October 1, so I think you may not really have a choice there. You may not be able to do it. And you know, if you did decide – so I would say, don't do that. I don't think you can do it.

However, if you decide that I would really like to start using the 15% as soon as it's available to you, so on every award that starts after October 1, you're going to have a more complicated annual budget to do, because you're going to have to do it in segments that reflect how we're handling this in the two different parts of our fiscal year, the part where we are charging 10% on all of our awards, and the part where we have some new awards that started after October 1, and we're going to charge 15% on those. So it will make your budgeting more complicated. It might make your accounting more complicated. But if you're eager to get there, you know, if you're feeling like that 10% is just so inadequate that really we shouldn't go on another nine months with it, you could make it work.

I think it would be complicated. It's definitely simpler to just say, “nope. I'm going to wait till the start of my next fiscal year, July 1. I'm still going to have to review all the awards that we're going to use in that coming fiscal year, that July 1, 2025, to June 30, 2026 fiscal year,” because if some of those are awards that have been in place prior to the new de minimis rate, you're going to have to, I would say, have some communication with the funder. Because it certainly would be simpler at that point if you would be permitted to apply it. But I think it may have to be funder by funder, and you're probably not going to have too many agreements that really don't meet the standard of "did this award begin October 1 or later? That in itself, is a little bit of a complicated question, but we're probably not going to delve into it right here.

[Jon]
Can I ask a question from the chat? This one is pretty complicated as well, but let me know. Someone says ***they have over 100 grants, and they all start at different times of the year. They're currently on the de minimis, each grant budget that was submitted at 10% - would they need to use 10% until all the new contracts and budgets get completed with the higher amount? Will they need to charge these grants separately until each award is renewed to the higher amount?***

[Kay]
Yeah, that is a really difficult question, and I think that I would kind of look for a simplicity strategy. I would first analyze, "okay, the earliest we could possibly use it with certainty is on the awards that start after October 1. So what portion of the total money that we're talking about here is in those awards, as opposed to in these awards that were opened before that, and have the 10%?" I might go further, and if I ended up saying, "well, yeah, really, we've got these direct federal awards that run with a federal fiscal year. So they're going to start October 1, and they are the bulk of our funding, and we want to take the 15% on those." Then I would look at – the next category I would look at, which would be large awards that started before October 1. And I would consider opening a discussion with my funder on that to say, "could we, do you believe that we can change the de minimis rate we use for the balance of this award?"

Now, you know it's going to change the budget of the award, right? Because we're going to switch from showing 10% indirect to showing 15%. So I think you're going to have to have funder cooperation on that, and I'm not sure that you're going to get funder cooperation on all of these awards. So then it becomes a question of, you know, how much time are you going to spend dealing with the requirement that you keep these awards separate in how you record the charges to them. Now one thing you could do that might be a simplicity solution is you might say, "well, I'm going to start October 1 putting all my indirect costs into a pool, and I'm going to consider that my indirect cost rate is 15%, and I'm going to apply that to all of my cost centers. It's just that when I request payment from those awards that are the old awards that started before October 1, I will continue to only request 10% and I will cover that missing 5%." But that's the problem. How are you going to cover it? Because if you say, "well, I'll break some costs out of my 15% indirect cost pool," you've just created a really complex situation. So I'm not sure that's a solution.

I'd be inclined in my system to say, well, I'll wait till the beginning of my next fiscal year. I'll see if at that time I don't have most of my awards available for the 15% rate, and then I'll make some trial runs at talking to the funders that are still going to be under the 10% rule and see what they would say. I'm not sure you're going to get a positive response. So in that case, you are going to have to deal with this problem of two different rates. This transition is not going to be easy, is what I would say.

Okay, now I think we're on to this next question. Did we already do this? I think we might have,

[Jon]
Yep.

[Kay]
Let's go on. All right. This is interesting. This person said, ***well, we have a NICR negotiated rate agreement that is at less than 15%. Despite having that rate agreement, can we still charge the de minimis rate of 15% to federal awards?*** No, you can't. You cannot charge the de minimis rate while you are still under a negotiated rate. That's really clear. So you're going to have to get out of the negotiated rate before you can start charging the de minimis rate. And you know, here's my final bullet point three. If you had a negotiated rate that was less than 15% – significantly less – my question would be, are you sure you want to go to charging the full 15%? Because I would assume that if you had that negotiated rate that was much lower, you didn't really have indirect costs equal to 15% and making this change is going to give the people who run the program less money for direct cost. So I think this is a strategic question that you would want to look at. But in terms of the compliance question, you cannot charge the de minimis rate while you still have a negotiated indirect cost rate. You have to bring it to a happy ending.

Okay, now we're going to talk about planning your transition to the de minimis rate. Well, the first thing those of us that have HHS money have to do, is we have to pay attention to whether HHS is actually going to adopt the 2024 revisions to the Uniform Guidance. Now I keep asking the folks at CAPLAW that question, "have you heard anything you know, when are they going to say what they're going to do?" And I think your latest answer was, "well, we have informal information that makes us think that yes, they are going to adopt the 2024 revisions, but we don't have any formal notification of that."

Now, let's just remind ourselves, why do we care about this? Why do we care what HHS does? Well, until they decide to adopt the 2024 revisions to the Uniform Guidance. We can't use the 15% rate, and we might be one of the Community Action Agencies that is stuck in this additional problem of having had a federally negotiated indirect cost rate in the past. The version of the Uniform Guidance that HHS has adopted is the 2014 version, where it said that if you had ever had a federally negotiated indirect cost rate, you could not use the de minimis rate. Now, the Uniform Guidance changed in 2020 and dropped that requirement, and said anybody that doesn't have a current federally negotiated indirect cost rate can use the de minimis rate, but until HHS joins the party and adopts the 2024 revisions, those who have HHS funding are going to be kind of stuck with the old rule. So, you know, join us in chanting that HHS has actually already decided, and they're just planning to have a big surprise announcement when they tell us that they're going to do it. But we don't know what's going to happen.

So okay, so that's the first thing. And so if you're working on your 2024/2025 budget right now, you're going to have to make some assumption about whether HHS is or is not going to adopt the 2024 revision, so make that assumption. And then start working on your agency-wide budget that would reflect your planned use of the de minimis in terms of transition timing. You can wait until you can use the revised de minimis rate for your entire fiscal year. For example, implement for calendar year 2025 or you can develop your budget in multiple segments to show using the rate at different levels for different parts of the year. I'm a big fan of simplicity, so I probably would go for waiting until the beginning of my calendar year. But I also recognize that that's not going to entirely solve the problem if you, as you enter 2025, are still going to have some significant awards that are subject to the 10% rate.

Okay, now we've got a few more challenges to talk about. Administrative cost caps, really sort of the bane of our existence, I would say. And also the impact of discovering that when you do the modified total direct cost rate base calculation, your actual indirect cost rate would need to be higher than 15% in order to fully recover your indirect costs. And we're going to talk about those two issues. So let's start with the admin cost caps.

What are these? Well, they come from statute. When these particular programs were adopted by Congress, they put a provision in that limited the amount of the funding that can be used for administrative costs. And the thing to listen for is that almost all of these, in fact, I haven't found one that is not a cap on administrative rather than on indirect costs. And if you've been going to these workshops, you know that those things are not identical.

And what's an example of how they're not identical? Well, I think we've talked about the situation where, you know, Head Start turns out to be one of these statutory caps at 15% admin. But we know that when Head Start is talking about administrative costs, they mean not only the share of your agency-wide administrative costs that you have given awarded to Head Start through either cost allocation or the use of the de minimis. But they're also talking about the direct administrative cost. For example, the Head Start program director is performing administrative functions, so when they're talking about how much administrative cost did you have, they are expecting you to combine those numbers. That's not the definition of your indirect cost, because those direct program administration costs in Head Start, they don't benefit the other programs, and they would not be being recovered through an indirect cost rate. So the language is frustrating here.

So what are you going to do? Well, you're going to check the actual regulations for your funding source to clarify what base they are telling you to apply the administrative cap to. The cap could apply to all the direct cost of this program or award, or it could apply to the modified total direct cost. You're not going to know until you read the regs. And I read the Head Start regs, and they say all direct costs of Head Start. So that is not the same thing as modified total direct costs. They do typically combine allocated admin cost with direct admin cost. So be sure, when you're testing the cap, you're combining your allocated and direct administrative cost.

Now this is the math. Some people are good at math. Some people hate math. 10% admin cap, if it's computed on the total direct cost, it may give you a higher number than what you get when you compute 10% of the modified total direct cost. Remember, we've looked at all these samples where we had to exclude costs that are direct costs, they're allowable costs. They're going to be charged to that award. But the modified total direct cost base method made us exclude them. So if we take 10% of that smaller number, it's going to be a lower number than 10% of the total direct cost. How much smaller? Well, it depends on your situation, and so all you can do is test it.

Now, the other thing to keep in mind is that if you actually have a negotiated indirect cost rate, you may have put a bunch of other shared costs that are not administrative costs into that indirect rate. And so you may not want to be trying to think about this as our entire indirect charge through a negotiated rate. Now, when we're in the de minimis rate, you could argue that it's not all admin, but I just don't think it would be worth the argument.

Now here's an illustration of what we're really talking about, and some of this is going to look really familiar if you were with us before and saw just the whole calculation of the modified total direct cost rate. So in the purple side of this chart, we've got four cost centers. Most of them are award-based cost centers, but we've got an unrestricted cost center, because very few of us actually can get by with no unrestricted funds.

And what we've done in each of those awards and in the unrestricted sources, is we started with the total direct cost, and then we thought about, what do I have to exclude from these total direct cost to get to the modified total direct cost? And so you can see what we excluded there in the middle white column, the excluded direct cost. And if you remember this example from before, we were excluding $40,000 that exceeded the portion of a sub award that this Community Action Agency made, and that was a requirement of the modified total direct cost method that you exclude the portion of a sub award that in the old days – in the 10% days – exceeded $25,000. So that's what that $40,000 is, and it came out of the total direct costs of award three so then we know that the 10% allowable indirect cost rate would result in charging what's in that yellow row. In other words, we're going to charge indirect costs of $100,000 to award one and $210,000 to award two and so on down the rows. And that's what we're allowed to charge with the 10% indirect cost rate.

But suppose in award one I have a 5% admin cap. Well that's going to tell me that I probably cannot charge $100,000 in indirect costs to that award, and so I can't. I'm going to have to take that out of what I am charging to that award, but it's not going to be magically transformed into some sort of direct costs that I could charge to it. These are costs that we already defined as indirect. And so on that light blue line, what we're doing is we're showing that I can't claim that $50,000 because of my admin cap. I'm going to have to have somebody pay for it. So I'm moving it over to the unrestricted sources cost center. And when I look at what can I charge totally to award one, well, the modified total direct costs - I can charge those. I can't charge the $100,000 in indirect cost. I can only charge $50,000 in indirect costs. So the total I'm going to be able to charge to that award is $1,050,000.

Now, when we come over to the unrestricted source column -- I mean, this is sort of a dumping ground, you have to admit it. It's where we're putting all the things that we can't charge to the federal awards. So the $50,000 that exceeded the 5% cap goes in there. And if you remember this example from before, the $10,000 that I tossed in there was because over in the white columns, we had an unallowable indirect cost.

Real story, a Community Action Agency that always had an open bar for their board members at board meetings had high attendance, but they had quite a bit of alcohol expense, and that is an unallowable cost. It can't be put into the indirect cost rate. So we got to pick that up with our unrestricted money. And the other thing we had to remember was that, because we have to charge the de minimis rate, the 10% rate, fairly across all cost centers, we had to charge it to the unrestricted cost center too, where probably we've got some foundation grants in here, where they say, "indirect costs, you're joking. We don't pay that."

So when we look at, "well, how much unrestricted money do we really need to have to make this all work?" Well, the answer is the $200,000 that are in direct costs from these unrestricted sources, the $20,000 in de minimis rate indirect costs that we put in there, the $50,000 that we couldn't cover in award one because of the administrative cap. And then the bar bill, the $10,000 of unallowable indirect costs. So what we hope we have in unrestricted funds is $280,000.

So these administrative cost caps really, I think, create problems, unless you can do that analysis we talked about before of saying, "well, what were they really talking about in this administrative cost cap? Were they applying a percentage to all direct costs? Because that might give us a way out of this problem." So here's the steps that I use to try to deal with this problem. I started by saying, you know, this is not de minimis number one. If you're still using the direct charging method – you know that we've talked about before, and CAPLAW has a guide on using the direct charging method – you would want to be sure that you had fair allocation methods in your cost allocation plan to allocate your agency-wide admin cost to all cost objectives, both those with an admin cap and those without.

And you could not tweak that allocation method to somehow give less, you know, a lower percentage to the programs that have admin caps. The whole point of cost allocation is fairness, a reasonable estimate. So you're going to go ahead and give everybody an allocated share that is computed the same way. If you're using the de minimis rate, you're going to remember, "I have to apply it to all my cost objectives, both the awards that have administrative cost caps and the ones that don't. I got to put it in there. If I have a NICR negotiated rate, I got to apply it to all cost objectives."

Now, you've also got to look for any direct admin costs that are charged to specific cost objectives, and we talked about the example of the Head Start director admin cost that was directly charged. And earlier we talked about, "well, what if I hire an accountant that does nothing, nothing but accounting for Head Start?" I could direct charge that. So I find those, and that still would be administrative, because accounting is always administrative. So I could find my direct admin costs.

So next step, I'm going to add those direct admin costs to the allocated agency-wide admin costs – or the indirect cost rate, if that's how you did it – that I charged to each cost objective to get to the total admin cost for that cost objective. I'm going to look again at which funding sources have these statutory caps, and I'm going to determine which ones of those funders are not going to be able to reimburse me, my total admin cost because of the admin cap. And, you know, I'm going to do as much as I can to be sure that I I've understood the cap, I've done the computation of what they can cover and if they had their cap based on percent of total cost, maybe there's some room for me to do better. But the end of this story is that if I can't find a way out, I'm going to have to have some unrestricted funds to cover the gap between the fair distribution of my administrative costs, and this restriction that says there's an admin cap on this source.

So now we have a question about that. This person is saying, well, you know, Head Start has 15% cap on all admin costs, both allocated or indirect cost rate and direct," and so they end up saying, so the 15% maximum admin cap would be a different calculation from the indirect cost rate? Yes, it would, because the 15% admin cap is on the total direct costs in the award, not the modified total direct cost base. And so it is possible that you could calculate 15% of the total direct costs in the award and compare that number to the results you get when you add the direct admin and the 15% indirect cost rate, maybe it would work.

How could it work? Well, if you had to exclude substantial amounts from the modified total direct cost base for Head Start, that's where you might have a little room to move here, because that's what would cause the 15% of the total cost to be significantly higher than 15% of the modified total direct cost base.

All right, now we're coming to another problem.

[Jon]
Can I just ask quick, a quick follow up question to something you said? Someone's asked, ***do the unrestricted funds needed to cover a gap go to the grant, or can it be reallocated back to the administrative pool?***

[Kay]
Well, you know, there'd be a lot of ways of showing this in the accounting system. One way would be to actually show the full cost of the program, okay? So that's all the direct Head Start cost, plus the indirect rate that we're charging to everything. That's the total cost of the program. And that could appear in my accounting system. A lot of organizations don't actually post the allocation of the indirect costs in the accounting system. They keep it in an indirect cost pool, and then they do this on a worksheet where they've got, you know, "what's in my Head Start cost pool," all the direct costs. They've got that number. "What's my indirect cost rate? I got that number, and that's my total Head Start. That cost that I would put on a report to Head Start." If you're using that method, you're not allocating those indirect costs by an entry in the general ledger. That's still okay. You're showing that you're doing the calculation, but you would have another step because of this cap. And you would have to show that, after you did all these calculations we talked about, if there was still some portion of those indirect costs that you couldn't cover, then you would show that you are reducing that from what you are going to charge to Head Start. And then you would show how you are going to cover it.

You could do this on a worksheet. In other words, you could leave all your unrestricted funds in an unrestricted cost center. You just want to be sure that you had some excess there, that the total unrestricted income was greater than the unrestricted expenses. So you could see, yeah, I do have money to use to subsidize and you could do this all in a worksheet, or some people probably are doing it in their general ledger. Some people are probably saying, "well, the way I'm going to look at that, is I'm going to look at not the award as the cost center, but the program as the cost center. And I'm going to show that I have two sources of funding for this program, my big Head Start grant, and whatever the unrestricted source is. And together, they can cover all the cost, the full cost, but I'm going to show that I'm charging the portion of the admin costs that exceeded the cap." That portion is going to be paid by the unrestricted source, or maybe you have some other source that is willing to pay it that isn't like a foundation grant.

So there's a lot of choices in how people set up the actual general ledger accounting. The important thing is that when they start doing these worksheets to calculate, "what am I going to charge to my different funders," that they can tie them directly to general ledger information. And there's so much variation, I kind of hesitate to go further than that.

Besides, we have another problem to talk about, which is, ***what if I do this modified toll direct cost calculation for my indirect cost rate?*** And the answer turns out to be more than 15% and that's what happened in this example. And you know, all these examples have been using that $4.45 million as the total expenses, but if you've been watching these slides, the total in the modified total direct cost column changes. Because if we're going to have higher indirect costs and we've got a fixed amount of grant funding, well we're going to have lower modified total direct costs. It just has to be that way. It isn't like, "oh, I've got higher indirect costs. This funder is going to fund those." Well, maybe you've got a funder that acts like that, but most funders that I know say, "well, this is how much you're getting, and here's what you can spend it on." So this is a lower modified total direct cost. And the reason they did that is that when they were thinking about allowable indirect costs, they came up with a higher number that they wanted to put into the indirect cost category. They came up with $700,000 of costs that they wanted to consider to be indirect. Now, we know that they had to include all of their agency-wide admin in there, but they may have put rent. They may have put other shared costs, you know, like the janitor might be in there. So whatever they decided was going to go into the indirect cost pool, it's there. $700,000 – they take $700,000, this is down below in the white box – they took the $700,000 in allowable indirect costs, and they divided it by the modified total direct cost base, and the answer was 18.9%.

Okay, so what are we going to do if this is us? Well, first, let's see what would happen if we just left it at that. And I'm saying not a good answer, because what's going to happen is the 15% de minimis rate is only going to result in giving us $555,000 in indirect costs that we can charge to our various cost centers. And as a result of that, we're going to have $145,000 in cost that we put into that indirect pool that we can't recover by charging our cost centers. So what are we going to do with it? Well, what do we always do with it? We're going to put it into our unrestricted cost center, and that's quite a blow there, and they still picking up the bar tab, and they will need a drink by the time they do this, because they're going to see that it's going to be $379,000 that they have to have in these unrestricted funds. So I think most of us would say this is not a good solution unless we have a lot of unrestricted funding available.

So you know, what can you do if this is you? Well, I would say, take another look at what you put in that indirect pool. Maybe you've put stuff in there that you could pull out and use cost allocation to directly charge. And you know, another thing you could do is say, this isn't going to work for us, and if we have a direct federal award, like Head Start or another direct federal award, let's go ahead and negotiate an indirect cost rate, because they're still going to allow a modified total direct cost rate that is higher than 15%. Nothing has changed in the rules for negotiating an indirect cost rate, and this would work better for us. And you know, if you just can't negotiate, you don't have a direct federal award, you've already slimmed down that indirect cost pool as much as you think you can, you may just have to say we got to go back to direct charging. Use a cost allocation plan and direct charge, because that way we will be able to recover our full indirect costs. We just won't call them indirect costs, remember, because when we use direct charging, we allocate them and then we report them as direct costs.

Now that still leaves you with the administrative cap problem. Suppose I did decide to go back to direct charging. You know that admin cost cap, it doesn't just apply to somebody using an indirect cost rate, it applies to everybody. So I would need to go in and do that same calculation about, well, how much in a share of agency-wide administrative cost am I charging to this award? How much do I have in direct administrative cost? What's the total? Does that exceed the cap?

Okay, now you may think, "well, why would we even talk about this monitoring of your de minimis rate if we're not involved with a federally negotiated indirect cost rate?" You know, if you do have a federally negotiated rate, obviously you do need to monitor your use of the of your indirect costs, because you've got a whole different motivation for monitoring than the people using the de minimis rate. So we're going to talk about the de minimis rate monitoring that I think makes sense. But you've always got to remember, I'm sort of conservative, so you might not look at it this way.

Okay, so what do you do to monitor it? Well, take a look at your financial statements every month, and figure out what your actual modified total direct cost, indirect rate would be. You know the formula. Just look at the modified total direct costs, and look at what you've put to the indirect cost pool, and figure out what percentage it is. If you see that your actual indirect rate is higher than the de minimis rate that you're using, you've got to do something. Start reviewing the costs that you're putting into the indirect pool and see if there's any ability to not put so many costs in there, because otherwise you're not going to fully recover your indirect costs.

Now if your actual indirect cost rate is significantly lower than the de minimis rate that you've been charging, you could consider reducing the rate you charge to make more money available for direct costs. But you wouldn't have to do that, because this brings us to a really important point -- that you do not have to prove that you have 15% indirect costs or 10% indirect costs. So you could say, "well, that's fine. I'm not going to do anything about it."

Now, before we wrap up, we have to talk about some interesting questions people ask about dealing with pass-through entities, that's like your state agency that is handing you your CSBG or handing you any of these other federal funds. And the question is, ***can a pass-through entity dictate that a subrecipient not treat an expense such as the ED salary as partially direct, but instead require that it be 100% direct?*** Well, that requirement is not in the Uniform Guidance. But you know, there's the problem. You may not be able to persuade your pass-through entity of this. What I would do is I would call CAPLAW and ask them to help communicate with the funder and to point out to the funder that they can put that requirement in the contract if they want to, but what they can't do is use the information you submit to reject a cost that is, by definition, allowable under the federal rules.

So then we have another question that gets to this same point that what are you going to do when a pass-through entity seems to be interpreting the Uniform Guidance in a way that just doesn't seem appropriate? And I would start with CAPLAW to ask them what they think, and to see if they already answered this question in your state or another state, and sort of get some ideas about how you want to deal with it. And this is one that is just really – I have seen this. I think this is wild, but I have seen it happen. We have a funder passing federal funds through, it tells us we have to submit backup costs for either a negotiated indirect cost rate, or the de minimis rate. It does not say that in the Uniform Guidance. The Uniform Guidance says, if you have a negotiated indirect cost rate, your pass-through entity must accept it, and if you are using the de minimis rate, they must accept it. But again, they can add these requirements that you submit into their contract. But what they can't do is then look at what you submitted and say, "oh, well, I see that the backup on the de minimis rate shows that you only had 14% indirect costs, so we're not going to pay the 15%." They are not allowed to do that because the Uniform Guidance says, "no, it's de minimis. You're entitled to it." And same thing with the federal rate. It's not for the state to say, "well, I noticed that you actually have indirect costs less than your federal rate." The federal government will take care of that. That is not the pass-through entity's job.

So, what are you going to do about it? Well, I think you've got a real issue if they are trying to tell you that they will not allow you to charge the full de minimis rate or your full indirect cost rate. But I expect this is going to be an argument, and so my suggestion would be to call CAPLAW and see if they would take it on. Now I realized when I was putting these slides together. I just created all this work for CAPLAW, and you guys are eager, right, to tackle these problems? They're by the phones now, dial in the next five minutes and you know, you might get a special on their help with this.

I think we're to the more questions, but we have a few minutes left. Have you seen something interesting in the questions, Jonathan?

[Jon]
Very interesting questions, yeah, they're all interesting. A good one, one is if we – I think has to do the transition to de minimis – if an organization transitions to the de minimis, it's not working out, and they transition back, and the process for doing that.

[Kay]
Yeah, Well, I guess it's back to what.

[Jon]
They're currently using cost allocation, they said.

[Kay]
Right, I have had some state pass-through entities say, "no, you can't go back," but I don't see that in the Uniform Guidance, did you? I think I wouldn't do it in the middle of the year. That would just create havoc. I would do it at the beginning of a fiscal year, I would notify all my funders that that's what I was doing. And I don't know that this would actually cause a terrible problem, even in the awards that you that are carrying over that you had from last year when you were using the de minimis rate. I would certainly talk to the funders of those awards to make sure that they were not going to have a problem saying, "well, you know, the approved budget on this shows the use of the de minimis rate, and now you're showing something else." I think this may have to be a problem that you just worked out together. What's the worst thing that could happen? Well, you're going to be in this situation we talked about. Some of your awards allow you to go back to the direct charge, and some of them require you to keep to the 10%. That's going to be a complicated situation. What if I want to go back to a negotiated rate? First I have to be eligible to negotiate, then I have to decide what period I'm going to negotiate for, and you're going to keep using the de minimis rate till you get a negotiated rate.

[Allison Ma'luf, CAPLAW]
I can jump in with a question. Someone asked, "*we have one child care state grant that will not permit an indirect cost rate of any kind. Can we first direct charge those admin costs and then put the remainder of the indirect admin cost into the indirect cost pool and use a de minimis rate for all the other grants?* "

[Kay]
Well, one idea that I would have – that might be the same thing they're talking about just said differently – but I would say I'm using the de minimis rate. I've got my cost centers organized by award. I would go ahead and apply the de minimis rate to every one of my cost centers. When I came to that state child care award and I was going to submit my financial reports and request reimbursement, I would feel free to take that amount that I had charged to the de minimis rate – you know, my 15% de minimis rate – I would look at the costs that were actually line item by line item in my indirect cost pool, and I would say I'm using that as the basis, the starting point for allocating. In other words, what's in that pool is 100% of what I've got. Now I'm going to use a fair allocation method to show what portion of that I am going to direct charge to this child care grant, and then I would test the answer that I got to be sure that all those different allocated costs that I was going to charge directly to the child care grant added up to the same amount as what I had put in my formal system, the 15% indirect rate. In other words, because they're so foolish, I am just giving them a breakdown of what I otherwise would have just called indirect. But instead, what they will see is an allocated share of salaries for people performing accounting, salaries for people performing board support, allocated share of the audit. They're going to see the detailed costs that are represented in my accounting system and all the other programs by the 15% indirect cost rate.

And so I think if I were then challenged, "well, you know, where'd these numbers come from that you reported to us," I think I would be able to have a good case that will start by looking what was in the indirect cost pool. Look at what would have been assigned to your program through the use of the indirect cost rate. There's X dollars in there. By analyzing the line item costs that are in the indirect cost pool, I can tell you what's in that number. I'm going to charge that as direct charging. There's probably going to be a little translation required, because they're probably going to say, "well, you can't just say I did it because it was in the indirect cost pool," but what you're saying the same thing as a rate. You're going to have to have an allocation method that would end up with that.

on direct charging, so that is a great resource. And they've done webinars on that, so you have a resource on that. And if you're negotiating an indirect cost rate, that's a whole other kettle of fish. And I can't remember whether we did a webinar on that, but maybe you guys want to do that, if you just want to torment yourselves.

[Allison]
Yeah, that'll be next, right? We haven't done one in a while, though, I think the last time we did a really intense indirect cost rate review was when the Uniform Guidance was initially issued, and you did a very extensive webinar series for us on that. So maybe that's our next refresh in the line.

[Kay]
Yeah. Well, whatever. Okay, so thank you all to everybody who sent in questions, that really helped.

[Jon]
Yeah, it was certainly helpful, and we're glad to have you, Kay. Thank you very much for your assistance with all this. The recording for this session and the slides will be made available as well on the website, and you'll be receiving in your email boxes an evaluation form as well. So thank you again, Kay and everyone who joined and we look forward to communicating with you in the future.

[Kay]
Great, thanks.

[Jon]
Bye.

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