Indirect Cost Allocation Bases for Non-profit Organizations

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Cost Allocation

Cost allocation is the process of identifying, aggregating, and assigning cost(s) to one or more cost objectives.

This term includes both direct assignment of cost and the reassignment of a share from an indirect cost pool.

- Achieved By Distributing or Apportioning Costs to a Benefiting “Cost Objective”
Direct Costs and Indirect Costs

- **Direct Costs:** is defined as any cost which is identified specifically with a particular final cost objective. Direct costs are not limited to items which are incorporated in the end product as material or labor. Costs identified specifically with a contract are direct costs of that contract. All costs identified specifically with other final cost objectives of the contractor are direct costs of those cost objectives.

- **Indirect Costs:** is defined as any cost not directly identified with a single final cost objective, but identified with two or more final cost objectives or with at least one intermediate cost objective. Simply, after direct costs have been determined and assigned directly to awards or other work as appropriate, indirect costs are those remaining to be allocated to benefiting cost objectives via an indirect rate.
Indirect Rate

Indirect costs are not directly related to a single cost objective; therefore, they are allocated to the final cost objective via an indirect cost rate(s) (e.g. Facilities and Administrative (F&A), Fringe Benefit, General and Administrative (G&A), Overhead, etc.)

Therefore the Non-Profit Organization (NPO) has to establish an Indirect Cost Allocation Base. Typically the Cognizant Federal Agency Official (CFAO) allows the NPO to determine their allocation base. However, the allocation base utilized by the NPO must be in accordance with the applicable (1) cost principles (2 C.F.R Part 220, 2 C.F.R Part 225, 2 C.F.R Part 230, etc.); (2) Cost Accounting Standards (CAS – if applicable); etc.; in addition, it should produce an equitable and consistent distribution of costs to the final cost objective.
Indirect Cost Allocation Bases

If the NPO does not have CAS-covered awards, they can utilize one of the Indirect Cost Allocation Bases to calculate the indirect cost rate:

- Direct Allocation Method
- Multiple Allocation Base Method
- Simplified Allocation Method

See attached excerpt
- ‘Indirect Allocation Base Excerpt.docx’
- 2 C.F.R Part 230
- 2 C.F.R Part 200
Direct Allocation Method

Utilized when NPO treat \textit{all} costs as direct costs\textsuperscript{4} except general administration and general expenses. The NPO generally separate their costs into three basic categories:

1. G&A and general expenses,
2. Fundraising, and
3. Other direct functions (including projects performed under Federal awards).

\textbf{Note:} This methodology allocates support costs \textit{only} to Operating Departments as it ignores any services provided by one service department to another.
An Example of Direct Allocation Method

Rent Expense

- Cooperative Agreement B
- Indirect Cost Pool (G&A)
- Contract
- Grant A
Multiple Allocation Base Method

Utilized when NPO determines it is organization’s major functions benefit from its indirect costs in varying degrees. The NPO accumulates indirect costs into separate cost pools (groupings); which, allocates each pool to benefiting functions using a base which best measures the relative benefits (causal/beneficial). This allocation methodology considers any services provided by one service department to another.

**Note:** This allocation methodology must consider:

- An base best suited for assigning the pool of costs to cost objectives in accordance with benefits derived,
- Cause and effect relationship (traceable) exists between the cost pool being allocated and the cost objectives; and
- Logic and reason
Modified Total Direct Cost

2 C.F. R Part 200.68:

means all direct salaries and wages, applicable fringe benefits, materials and supplies, services, travel, and subawards and subcontracts up to the first $25,000 of each subaward or subcontract (regardless of the period of performance of the subawards and subcontracts under the award). MTDC excludes equipment, capital expenditures, charges for patient care costs, tuition remission, scholarships and fellowships, participant support, rental costs and the portion of each subaward and subcontract in excess of $25,000. Other items may only be excluded when necessary to avoid a serious inequity in the distribution of indirect costs, and with the approval of the cognizant agency for indirect costs.
Indirect costs shall be distributed to applicable sponsored awards and other benefiting activities within each major function on the basis of MTDC. MTDC consists of all salaries and wages, fringe benefits, materials and supplies, services, travel, and subgrants and subcontracts up to the first $25,000 of each subgrant or subcontract (regardless of the period covered by the subgrant or subcontract). Equipment, capital expenditures, charges for patient care, rental costs and the portion in excess of $25,000 shall be excluded from MTDC. Participant support costs shall generally be excluded from MTDC. Other items may only be excluded when the Federal cost cognizant agency determines that an exclusion is necessary to avoid a serious inequity in the distribution of indirect costs.

**Note:** Any contractor using the MTDC allocation base should be excluding “ALL Equipment, Capital Expenditures, Charges for Patient Care, Rental Costs (Equipment Lease, Space Lease, etc.) from the MTDC allocation base. They should also exclude each subaward in excess of $25,000.
Where an organization's major functions benefit from its indirect costs to approximately the same degree, the allocation of indirect costs may be accomplished by (i) separating the organization's total costs for the base period as either direct or indirect, and (ii) **dividing the total allowable indirect costs (net of applicable credits) by an equitable distribution base.** The result of this process is an indirect cost rate which is used to distribute indirect costs to individual Federal awards. The rate should be expressed as the percentage which the total amount of allowable indirect costs bears to the base selected. This method should also be used where an organization has only one major function encompassing a number of individual projects or activities, and may be used where the level of Federal awards to an organization is relatively small (refer to 2 CFR 200, Appendix IV, B.2, Indirect [F&A]) Costs Identification and Assignment, and Rate Determination for Nonprofit Organizations, Allocation of Indirect Costs and Determination of Indirect Cost Rates).
Simplified Allocation Method

2 C.F.R Part 200 Appendix IV Subpart B.2:

- a. Where an organization's major functions benefit from its indirect costs to approximately the same degree, the allocation of indirect costs may be accomplished by (i) separating the organization's total costs for the base period as either direct or indirect, and (ii) dividing the total allowable indirect costs (net of applicable credits) by an equitable distribution base. The result of this process is an indirect cost rate which is used to distribute indirect costs to individual Federal awards. The rate should be expressed as the percentage which the total amount of allowable indirect costs bears to the base selected. This method should also be used where an organization has only one major function encompassing a number of individual projects or activities, and may be used where the level of Federal awards to an organization is relatively small.

- b. Both the direct costs and the indirect costs must exclude capital expenditures and unallowable costs. However, unallowable costs which represent activities must be included in the direct costs under the conditions described in §200.413 Direct costs, paragraph (e) of this Part.
c. The distribution base may be total direct costs (excluding capital expenditures and other distorting items, such as subawards for $25,000 or more), direct salaries and wages, or other base which results in an equitable distribution. The distribution base must exclude participant support costs as defined in §200.75 Participant support costs.

d. Except where a special rate(s) is required in accordance with section B.5 of this Appendix, the indirect cost rate developed under the above principles is applicable to all Federal awards of the organization. If a special rate(s) is required, appropriate modifications must be made in order to develop the special rate(s).

e. For an organization that receives more than $10 million in Federal funding of direct costs in a fiscal year, a breakout of the indirect cost component into two broad categories, Facilities and Administration as defined in section A.3 of this Appendix, is required. The rate in each case must be stated as the percentage which the amount of the particular indirect cost category (i.e., Facilities or Administration) is of the distribution base identified with that category.
An Example of Simplified Allocation Method

- Rent Expense
  - Indirect Cost Pool
    - Cooperative Agreement B
    - Grant A
    - Contract
Regulatory and Other Guidance

Cost Accounting Standards (CAS)
- CAS 401 - Consistency in Estimating, Accumulating and Reporting costs
- CAS 402 - Consistency in Allocating costs Incurred for the same Purpose
- CAS 403 - Allocation of Home Office Expenses
- CAS 405 - Accounting for Unallowable Costs
- CAS 406 - Cost Accounting Period
- CAS 410 - Allocation of Business Unit G&A to Final Cost Objectives
- CAS 418 - Allocation of Direct and Indirect Costs

Federal Acquisition Regulation (FAR)
- Subpart 2.1 - Definitions
- Part 31 – Contract Cost Principles and Procedures
- Subpart 42.7 – Indirect Cost Rates
- 52.216-7 – Allowable Cost and Payment Clause

Code of Federal Regulations (Previously OMB Circulars) - Prior to December 26, 2014
- 2 C.F.R Part 220 ‘Cost Principles for Educational Institutions’ (OMB Circular A-21)
- 2 C.F.R Part 225 ‘Cost Principles for State, Local and Indian Tribal Governments’ (OMB Circular A-87)
- 2 C.F.R Part 230 ‘Cost Principles for Non-Profit Organizations’ (OMB A-122)

Code of Federal Regulations (Previously OMB Circulars) – Effective December 26, 2014
Conclusion

The Indirect Cost Allocation Base utilized by an NPO should be best suited for assigning the pool of costs to cost objectives in accordance with benefits derived based on

✓ Cause and effect relationship; or
✓ Logic and reason

Note: If the NPO is required to have a OMB Circular A-133 'Audits of States, Local Governments and Non-Profit Organizations' audit performed, the DCAA audit should review the CPA firm working paper as the OMB Circular A-133 Supplement provides guidance related to NPOs that charge indirect costs to Federal awards based:

a) The methods for allocating the costs should be in accordance with the applicable cost principles, and produce an equitable and consistent distribution of costs (e.g., all activities that benefit from the indirect cost, including unallowable activities, must receive an appropriate allocation of indirect costs).

b) Indirect cost rates were applied in accordance with approved indirect cost rate agreements (ICRA), or special award provisions or limitations, if different from those stated in negotiated rate agreements.
• Any Questions