Cost Category Considerations for Grant Recipients

Bottom Line Up Front

Grant recipients navigate multiple complexities when managing federal financial assistance, including defining costs as indirect or direct and selecting the most appropriate indirect cost recovery strategy to maximize utilization of grant funds and cost recovery. Further, a lack of clarity and understanding of the associated cost accounting practices and consistency of treatment of certain costs as direct or indirect can cause serious compliance challenges for grant recipients.

In an environment where acceptable indirect cost rates is a topic of discussion and scrutiny from several federal grant-making agencies, it is critical for grant recipients to understand their current indirect cost methodologies and be prepared to revisit or adjust their strategies going forward to protect or enhance financial health.

What are Direct and Indirect Costs?

Direct costs are costs grant recipients can attribute specifically to program operations, which are reimbursed at the full level of the cost allocated to the grant. Indirect costs refer to costs a grant recipient cannot easily assign directly to a particular cost objective that help manage the administrative functions of their operations (e.g., overhead costs). Indirect costs are charged to an award as a percentage of the direct costs, allowing grant recipients to recover the costs of these operational activities that cannot be directly attributed.

Since grant recipients incur both direct and indirect expenses, they must consider their cost methodologies in a way to fairly represent their operational expenses so they can accurately charge program expenses against grant funds. Reporting an ineffective or inaccurate indirect cost allocation methodology or making poor strategic decisions for direct and indirect cost treatment can risk the underutilization of grant funds that may jeopardize the financial health of the grant-funded program.

Some grant recipients find it challenging to appropriately identify expenses as direct or indirect as certain types of costs may fall into either category or overlap depending on the organization's structure and/or cost accounting practices. Therefore, its critical for grant recipients to establish clear and consistent methodologies for how such costs are treated.

Examples of Direct and Indirect Costs

Direct Costs	Indirect Costs	Considerations
Salaries for staff that are directly involved in the grant program.	Salaries of the non-profit's accounting, leadership, or compliance functions that are not directly attributable to grant program operations.	Staff may directly work with the program or activity funded by the grant and can also support overhead or other grants. Timecards that allocate time between different programs or activities can help identify wages that can be charged to the grant as a direct cost.
Portion of office lease space occupied by grant program or activity.	Corporate office lease or depreciation of capitalized facilities .	Sometimes, corporate offices may employ staff who work directly with the program or activity funded by the grant. Allocations that divide office space usage by office square feet can separate the grant-related direct costs from other costs.
IT services utilized by grant-funded program activities.	Corporate IT services.	Consider a methodology that is reasonable to track these services to divide the allocation costs between a grant program's direct benefit or activity and organizational overhead.
Supplies and equipment used by the grant-funded program activities.	Corporate office supplies and equipment not directly attributable to the grant program operations.	Identify an approach that is practical to track supplies and equipment to divide the allocation costs between a grant program's direct benefit or activity and organizational overhead.
Project-related telecommunication expenses.	Corporate office telecommunication expenses.	Determine a feasible methodology to track expenses to divide the allocation costs between a grant program direct benefit or activity and an organizational overhead.

Note: If a grant recipient is choosing to identify cost types detailed above as a direct cost to a specific program or activity, it must also similarly attribute such expenses as direct costs to all other specific programs or activities it operates, regardless of funding source, and can only consider remaining items that truly support all operations in their indirect pool.

Applying Costs Against Awarded Grant Funds

Effective allocation of costs is critical to ensure expenses are appropriately charged to each program or activity and that the grant recipient can accurately track and report the charges to a grant program on its financial reporting. This includes the detail of costs included on a grant recipient's invoices or reimbursement requests and its Federal Financial Reports (SF-425), a reconciliation the grant recipient is required to submit periodically that illustrates the financial health of the grant-funded program or activity.

There are different methodologies to calculate the amount of indirect costs charged to the grant. Grant recipients may elect to establish a Negotiated Indirect Cost Rate Agreement (NICRA), which is calculated based on the specific indirect costs incurred by each organization and reviewed and negotiated with the organization's cognizant or oversight agency (the agency that represents the largest proportion of funds received by the organization). Establishing a NICRA allows a grant recipient to reflect the full cost to run its business and elect the most effective or appropriate distribution basis against which its indirect rate will be applied. Once in place, a NICRA must be accepted by any federal funding agency.

Recipients who choose not to (or may not be eligible to) pursue a NICRA can use the de minimis rate established in 2 CFR 200.414(f). This allows organizations without a current NICRA to use an indirect cost rate up to 15% (increased from 10% as of Oct. 1, 2024) of Modified Total Direct Costs (MTDC) charged to the grant. MTDC are direct costs, excluding equipment, capital expenditures, charges for patient care, rental costs, tuition remission, scholarships and fellowships, participant support costs, and the portion of each subaward in excess of $50,000 (increased from $25,000 as of Oct. 1, 2024).

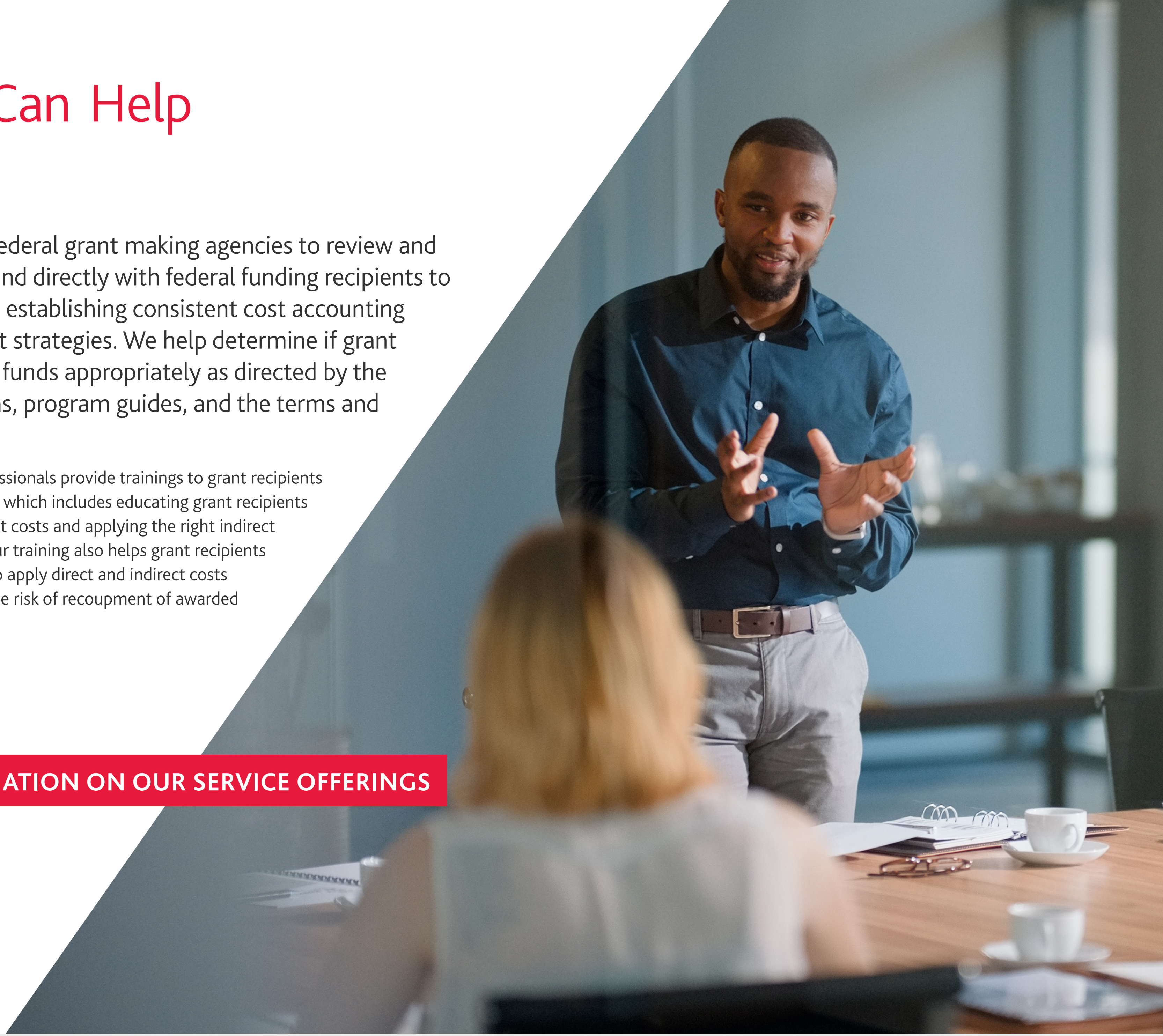
Examples of Direct and Indirect Costs

Negotiated Indirect Cost Rate Agreement	De Minimis Rate
Formal written agreement resulting from a negotiation between the grantee and the cognizant federal agency describing the approved rate and distribution method for a grantee to apply indirect costs.	Percentage of the Modified Total Direct Cost (MTDC) that can be used by grant recipients who do not have a current NICRA.
NICRA agreements must be routinely updated and renegotiated (every 1-4 years, depending on the nature of the organization and rate established).	MTDC includes all direct salaries and wages, relevant fringe benefits, materials and supplies, services, and travel.
Requires a comprehensive understanding of financial operations, such as adjustments to historical expenses, cost pools, unallowable costs, and other financial factors.	MTDC excludes equipment, capital expenditures, charges for patient care, rental costs, tuition remission, scholarships and fellowships, participant support costs and the portion of each subaward more than $50,000.
Benefit of Use: The grantee can recover a higher amount of indirect costs from the grant than the amount that can be applied using the de minimis rate.	**Benefit of Use:** The de minimis rate allows grantees to apply and recover some level of indirect costs without the need to follow the NICRA process. No documentation is required to justify the de minimis indirect cost rate.
Drawbacks: Use of this process is arduous in getting approval by the cognizant federal agency for the applied rate and negotiation and requires an annual true-up that may identify an under- or over-recovery of costs that must be incorporated into future calculations (or repaid to the government).	**Drawbacks:** Use of the de minimis rate may not be as advantageous as it may not provide for recovery of a grant recipients full indirect costs.

How BDO Can Help

BDO works closely with federal grant making agencies to review and oversee grant recipients and directly with federal funding recipients to helps navigate changes in establishing consistent cost accounting practices and indirect cost strategies. We help determine if grant recipients are using grant funds appropriately as directed by the code of federal regulations, program guides, and the terms and conditions of the grants.

Additionally, our experienced professionals provide trainings to grant recipients as part of our consultative services, which includes educating grant recipients on differentiating direct and indirect costs and applying the right indirect cost rate for their organizations. Our training also helps grant recipients make informed decisions on how to apply direct and indirect costs to their Form SF-425 and reduce the risk of recoupment of awarded grant funds.



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