

Indirect Cost Rates – A Hospital Perspective



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Agenda

- ❑ “Old School” versus new regulations
- ❑ Review of 2CFR 200 (not so new rules)
 - General provisions
 - Rules on cost principles
 - Rules on Indirect (F&A) costs
- ❑ How the Indirect (F&A) rate works
- ❑ Types of Indirect (F&A) rates
- ❑ Nuances of Indirect (F&A) rate rules (quirky rules)
- ❑ Computing/Negotiating an Indirect (F&A) rate
- ❑ Frequently asked questions



Formal Survey



- Survey
 - How many auditors?
 - Any Hospitals?
 - Government personnel?
 - Who has a federally approved rate?



What Were “Old School” Rules?

2CFR 200 – Replaces the OMB Circulars

- A-21 “Cost Principles for Educational Institutions”
- A-122 “Cost Principles for Non-Profit Organizations”
- A-87 “Cost Principles for State, Local and Indian Tribal Governments”
- A-110 “Uniform Administrative Requirements for Awards and Other Agreements with Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations”
- A-102 “Awards and Cooperative Agreements with State and Local Governments”
- A-133 “Audits of States, Local Governments, and Non-Profit Organizations”
- A-89 “Federal Domestic Assistance Program Information”
- A-50 – Sections Related to Audits Performed Under the Single Audit Act

New Rules (2CFR 200)

2 CFR 200 - Organization

- Subparts A - F (200.0 – 200.521) plus Appendices
 - A-Acronyms and definitions in the front
 - B-General provisions
 - C-Pre-Award – Federal
 - D-Post Award – Recipients
 - E-Cost principles
 - F-Audit

RULES!
1. You SHALL!
2. You WILL!
3. You MUST!

Effective Date - 200.110

- For new and incremental funding awarded after 12/26/14
- This means “Now”



Indirect Rules: 2CFR 200 Appendices

- Subpart E – Cost Principles (200.400 – 200.475)
- Appendix III – Indirect...Institutes of higher education
- Appendix IV – Indirect...Nonprofit Organizations
- Appendix V – Cost Allocation plans – State & Local Gov' t
- Appendix VI – Cost Allocation plans – Public Assistance
- Appendix VII – Indirect Cost Proposals – State & Local and Indian Tribes
- Appendix VIII – NFP Exempt from subpart E Cost Principles of Part 200
- Appendix IX – Hospital Cost Principles (45 CFR Part 75 Appendix E)

Why are there different appendices

- Operational structure different
 - Appendix III – Higher Ed
 - Instruction function, research, other Institutional activities (dorms, sports)
 - Generally much larger operational budget
 - Multiple rates (instruction; Research; etc.)
 - Appendix IV – NFP Organization
 - Generally smaller budgets
 - One rate (can have multiple)
 - Definition of indirect costs vary
 - Appendix IX - Hospitals
 - Clinical function
 - Allocate costs through a cost report
 - Common to have multiple rates





Appendix IX – Hospital Cost Principles

Based on initial feedback, OMB proposes to establish a review process to consider existing hospital cost determine how best to update and align them with this Part. Until such time as revised guidance is proposed and implemented for hospitals, the existing principles located at 45 CFR Part 75 Appendix E, entitled “Principles for Determining Cost Applicable to Research and Development Under Grants and Contracts with Hospitals,” remain in effect”



Hospital Regulations

- Applicable regulations in 45 CFR 74 Appendix E ("OASC-3, Cost Principles for Hospitals")

- OASC-3

- | | | | |
|------|-------------------------------|-------|------------------------------|
| I. | Purpose & Scope | VII. | Determination and |
| II. | Definition of Terms | | Application of Indirect Cost |
| III. | Basic Considerations | | Rate |
| IV. | Direct Costs | VIII. | Simplified Method for Small |
| V. | Indirect Costs | | Institutions |
| VI. | Identification and Assignment | IX. | General Standards of |
| | of Indirect Costs | | Selected Items of Cost |



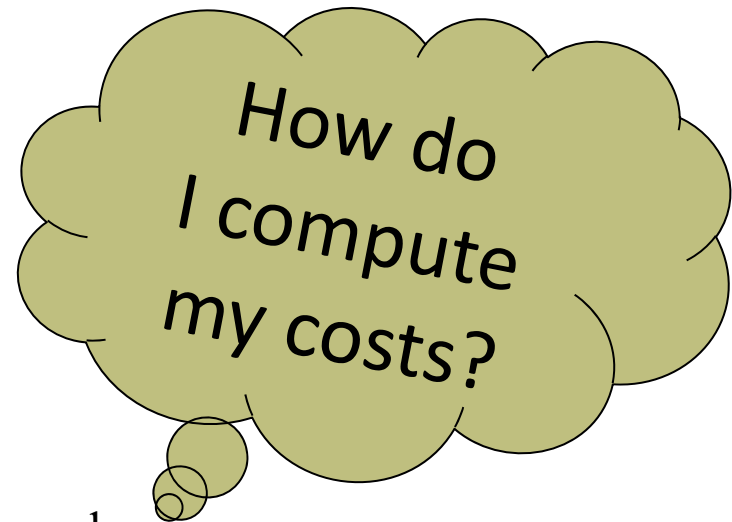
45 CFR Appendix E

UNIFORM ADMINISTRATIVE REQUIREMENTS FOR AWARDS AND
SUBAWARDS TO INSTITUTIONS OF HIGHER EDUCATION,
HOSPITALS, OTHER NONPROFIT ORGANIZATIONS, AND
COMMERCIAL ORGANIZATIONS

Appendix E to Part 74 - Principles for Determining Costs Applicable to
Research and Development Under Grants and Contracts With Hospitals

Cost Principles-Basic Considerations

- ❑ Consistent costs applied to contracts 200.403
 - Have good policies and procedures
- ❑ Reasonable costs 200.404
 - Sound business, market prices, etc..
- ❑ Allocable costs 200.405
 - Cost must be incurred for the award
 - Cost must benefit the award
 - Cost should be necessary
 - Costs must be appropriately allocable to award
- ❑ Applicable credits 200.406
 - Must use coupons to get best deal if available
- ❑ Prior approval 200.407
 - Suggested to get prior approval on unusual costs



Cost Principles: Direct Costs 200.413

- ❑ Costs that can be identified to the Award with relative ease
- ❑ Typical costs include:
 - Compensation
 - Fringe benefits
 - Cost of materials



Official definition- Indirect Costs / F&A Costs (200.56)

- *Indirect (F&A) costs* means those costs incurred for a common or joint purpose benefitting more than one cost objective, and not readily assignable to the cost objectives specifically benefitted, without effort disproportionate to the results achieved.
- To facilitate equitable distribution of indirect expenses to the cost objectives served, it may be necessary to establish a number of pools of indirect (F&A) costs.
- Indirect (F&A) cost pools must be distributed to benefitted cost objectives on bases that will produce an equitable result in consideration of relative benefits derived.

Translation

English definition: Indirect Costs (n) IN-der-EK-t/CAH-st

- Synonymous with Facilities and Administrative cost (F&A)
- Benefits different activities and cannot be easily identified to benefit any one activity.



Cost Principles: Indirect Costs 200.414



Normally those costs that are not direct

- Salary of Administration
- Other costs
 - Facility
 - Depreciation
 - Equipment
 - Operations/Maintenance
 - Administrative
 - Accounting, Legal, HR

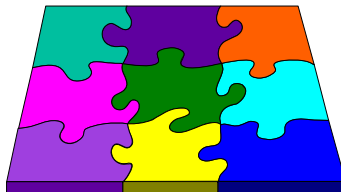
INDIRECT COST RATE CALCULATION EXAMPLE

F & A Costs

Overhead costs incurred to support Research activities:

- Depreciation of Buildings & Equipment
- Operation & Maintenance of Research Areas
- Administrative & General Services

\$58,000



Direct Costs

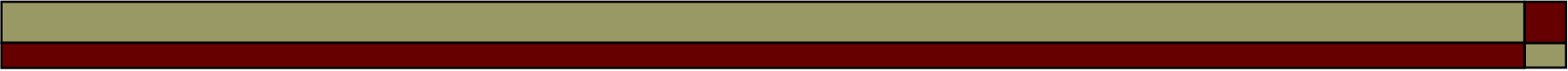
Costs incurred in performing sponsored project activities/protocols:

- Salaries and Fringe Benefits of Lab Personnel
- Research Supplies and Materials
- Research Consultants
- Travel

\$100,000

F & A Costs
Direct Costs

F & A Cost Rate = 58%



Common Nuances with Health Systems

- We have multiple hospitals can we get a rate agreement to cover all hospitals?
 - Yes, in general only if you are all under the same EIN
 - Each hospital might have their own rate listed in the rate agreement
 - If each hospital has a separate EIN then most likely you will need a separate rate agreement for each hospital or location



Hospital Nuances

- ❑ Negotiate with Cost Allocation Services of DHHS
- ❑ Generally need to use a Medicare Cost Report for allocations
- ❑ Not a lot of attention is generally given to Research and or Sponsored Projects when the cost report is prepared
 - Statistics need to be updated
 - Square footage
 - FTE's
 - Are the appropriate sponsored projects listed
 - Costs should be on line 191 or around that row in cost report
- ❑ OASC-3 / 45 CFR Appendix E
 - Last updated in 1974

OASC-3 COSTING PROVISIONS

- - APPLICABLE COST PRINCIPLES: 45 CFR 74 Appendix E (OASC-3)
-
- OASC-3 SECTIONS
 - I. PURPOSE AND SCOPE
 - II. DEFINITIONS OF TERMS
 - III. BASIC CONSIDERATIONS
 - IV. DIRECT COSTS
 - V. INDIRECT COSTS
 - VI. IDENTIFICATION AND ASSIGNMENT OF INDIRECT COSTS
 - VII. DETERMINATION AND APPLICATION OF INDIRECT COSTS RATE
 - VIII. SIMPLIFIED METHOD FOR SMALL INSTITUTIONS
 - IX. GENERAL STANDARDS OF SELECTED ITEMS OF COSTS
 - REQUIREMENT FOR INDIRECT COST RATE DETERMINATION
 - USE MEDICARE COST REPORT AS THE REFERENCE DOCUMENT
 - RESEARCH RELATED EXPENSES ARE ACCUMULATED IN LINE 97.XX (now line 191.xx)



The Basics

Indirect Cost Calculation

- Medicare Cost Report is the basis for indirect cost rate calculation
 - Research Costs on Line 191: one of several lines for non-patient care costs
 - Make adjustments as appropriate – update statistics
 - Cost report can be used to get Patient Care Rates as well (if you want a negotiated rate agreement for patient care which would be separate from a research rate)



The Basics

Indirect Cost Calculation

- **Organized research** means all research activities of a hospital that may be identified whether the support for such research is from a federal, non-federal or internal source.
- **Departmental research** means research activities that are not separately budgeted and accounted for. Such work, which includes all research activities not encompassed under the term organized research, is regarded for purposes of this document as a part of the patient care activities of the hospital.



The Basics

Indirect Cost Calculation

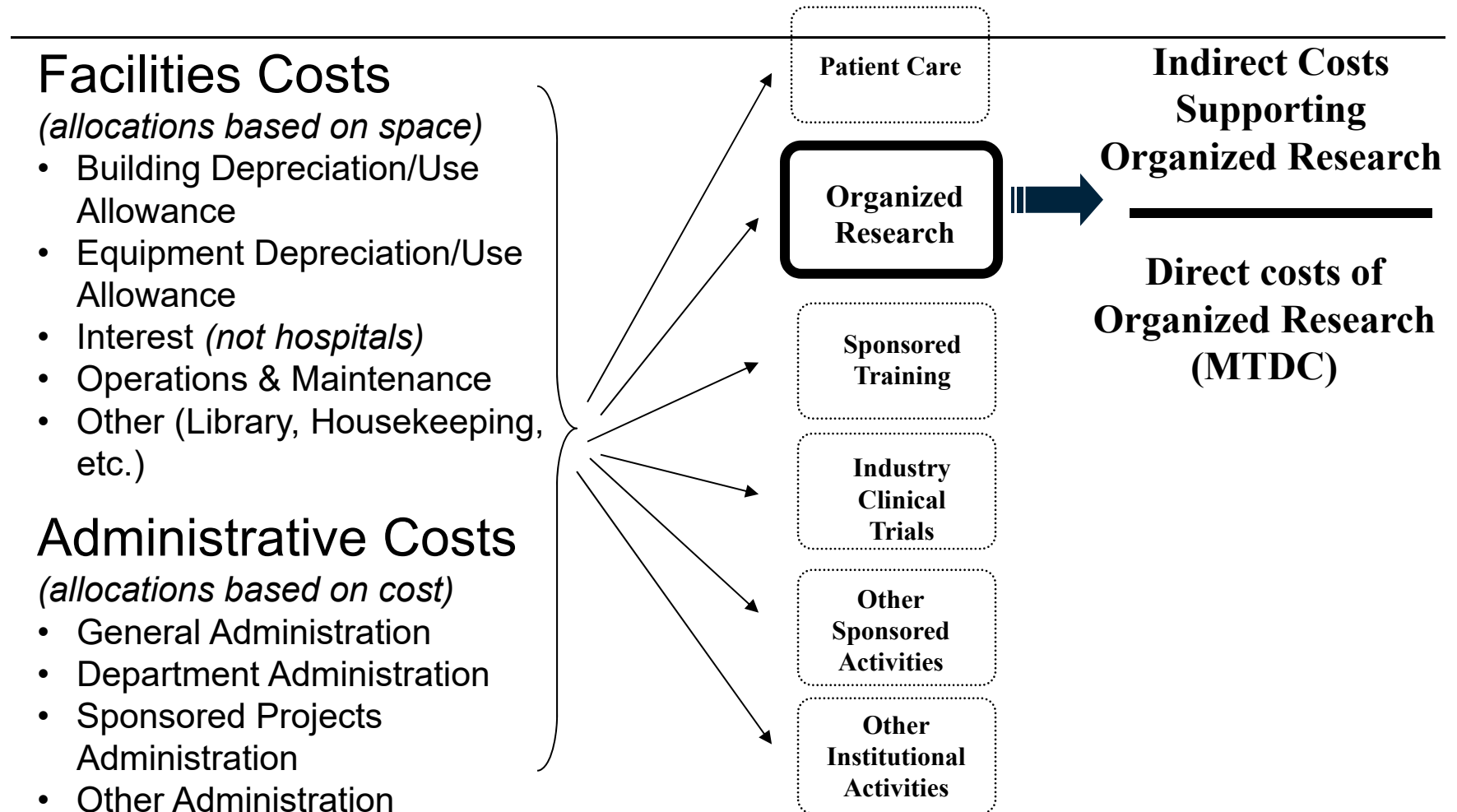
- **Other hospital activities** means all organized activities of a hospital not immediately related to the patient care, research, and instructional and training functions which produce identifiable revenue from the performance of these activities.



Medicare Cost Report

- ❑ Line 191 of the Medicare Cost Report: Research costs are typically captured here
- ❑ Often used as the “research denominator” in calculating the indirect cost rate
- ❑ Line 191 is frequently a mixture of costs including research, departmental research, and administration
- ❑ Analysis should be performed: What is in Line 191?

The Basics Indirect Cost Calculation





The Medicare Cost Report - Worksheet B Series

Worksheets

- B-1
- B, Part 1

Purpose

Cost allocation statistics

Allocate **all** costs of non-revenue units (indirect) to revenue units (direct)

Key Objectives:

- Allocate indirect costs to benefiting activities (patient care units, research, etc.)
- Institutions typically focus on the allocation of costs to departments that are cost reimbursed and are under limits, rather than to units that receive a flat fee DRG (Diagnosis Related Group) payment. Reimbursement offices often overlook the impact of allocations to research
- Balancing intermediary's desire to maintain same cost allocation methods as the past year, with cost reimbursement



FACILITIES COSTS

(Generally Allocated based on Sq. Ft)

- DEPRECIATION / UAL – BUILDINGS
- DEPRECIATION / UAL – EQUIPMENT
- DEPRECIATION / UAL – CAPITAL IMPROVEMENTS
- OPERATION OF PLANT
- MAINTENANCE OF PLANT
- LAUNDRY AND LINENS
- HOUSEKEEPING
- DIETARY
- MAINTENANCE (HOUSING) OF PERSONNEL
- MEDICAL RECORDS AND LIBRARY



Space

Research Space Considerations

- ❑ Space is the most important statistic in the allocation of indirect costs to research as a majority of facility costs are allocated on this basis
- ❑ Space already done for MCR at some level, but research space is not always considered
- ❑ Need to focus on functional use which is not always the same as the cost center use for which the space is mapped
- ❑ Separate survey is often required to ensure all research space is captured for sponsored projects and research

Indirect Rate Calculation
For the Fiscal Year Ended June 30, 2017

Summary

	Indirect Rate - Off Site		Indirect Rate - On Site		
Description	Research Line 191.00	Other Sponsored Activities Line 191.01	Research Line 191.00	Other Sponsored Activities Line 191.01	References and Notes
Indirect Costs:					
<i>Allocated Costs Per Cost Report:</i>					
New Cap Bldgs	\$ -	\$ -	\$ 651,060	\$ 3,424,001	Cost Report - TAB E
Capital - Patient Care Wings	-	-	43,661	-	Cost Report - TAB E
Capital - Total Hospital	-	-	201,630	927,977	Cost Report - TAB E
Moveable Equipment	-	-	321,515	1,479,736	Cost Report - TAB E
Employee Benefits	41,507	515,120	41,507	515,120	Cost Report - TAB E
Administrative & General	972,460	9,204,380	972,460	9,204,380	Cost Report - TAB E
Admin & General (Unallocable)	(582,080)	(5,509,417)	(582,080)	(5,509,417)	From Sch B
Maintenance & Repair	-	-	87,332	401,936	Cost Report - TAB E
Operation of Plant	-	-	335,826	1,545,598	Cost Report - TAB E
Laundry & Linen	-	-	-	-	Cost Report - TAB E
Housekeeping	-	-	152,350	701,172	Cost Report - TAB E
Dietary	-	-	-	-	Cost Report - TAB E
Cafeteria	-	-	-	47,916	Cost Report - TAB E
Nursing Administration	-	-	-	13,586	Cost Report - TAB E
Nursing Staff Development	-	-	-	-	Cost Report - TAB E
Central Services & Supply	-	-	-	621	Cost Report - TAB E
Pharmacy	-	-	-	5,586	Cost Report - TAB E
Subtotal Allocated Costs	\$ 431,887	\$ 4,210,083	\$ 2,225,261	\$ 12,758,212	
Allocation of Research Administration	\$ 65,459	\$ 795,471	\$ 65,459	\$ 795,471	From Sch E-1
<i>Total Indirect Costs</i>	<i>\$ 497,346</i>	<i>\$ 5,005,554</i>	<i>\$ 2,290,720</i>	<i>\$ 13,553,683</i>	
Total Direct Costs	\$ 2,614,668	\$ 29,208,158	\$ 2,614,668	\$ 29,208,158	From Sch A
<i>Indirect Rate</i>	<i>19.02%</i>	<i>17.14%</i>	<i>87.61%</i>	<i>46.40%</i>	

Rate Agreements, cont'd

HOSPITAL RATE AGREEMENT

BIN #:

DATE: October 28, 2005

HOSPITAL:

FILING REF.: The preceding
Agreement was dated
August 18, 2004

The rates approved in this agreement are for use on grants, contracts and other agreements with the Federal Government, subject to the conditions in Section III.

SECTION I: INDIRECT COST RATES*

RATE TYPES: FIXED FINAL PROV. (PROVISIONAL) PRED. (PREDETERMINED)

TYPE	EFFECTIVE PERIOD		RATE (%)	LOCATIONS	APPLICABLE TO
	FROM	TO			
FINAL	01/01/04	12/31/04	59.2	(1)	Sponsored Research
FINAL	01/01/04	12/31/04	30.0	Hospital	Other Sponsored Act
PROV.	01/01/05	UNTIL AMENDED	Use same rates and conditions as those cited for fiscal year ending December 31, 2004.		

*BASE:

Total direct costs less items of equipment and other capital expenditures, subawards, and hospitalization and other fees related to



“Never Had A Rate” Rule (200.414f)

- ❑ (f) any non-Federal entity that has never received a negotiated indirect cost rate, except for those non-federal entities described in Appendix VII to part 200 – State and Local governments Indian Tribe Indirect Cost Proposals, paragraph D.1.b.
 - ❑ May elect to charge a de minimis rate of 10% of Modified total direct costs (MTDC) which may be used indefinitely.
 - ❑ As described in 200.403 factors affecting allowability of costs, costs must be consistently charged as either indirect or direct costs, but may not be double charged or inconsistently charged as both.
 - ❑ If chosen, this methodology once elected must be used consistently for all federal awards until such time as a non-Federal entity chooses to negotiate for a rate, which the non-Federal entity may apply to do at any time.



Frequently Asked Questions

Question: Our organization previously had a negotiated indirect cost rate. However, all federal awards expired causing a break in our relationship with the federal government. During the break in the relationship our negotiated indirect cost rate expired. Our organization has now received a new federal award.

Are we eligible to receive the 10 percent de minimis rate?

Answer: No, Organizations that experience a break in federal relationships are not eligible to receive the 10 percent de minimis rate up on receipt of a new award. The availability of the de minimis rate is specifically limited to non-federal entity that has never received a negotiated indirect cost rate (200.414 (F)). It is expected that organizations that have experience developing and negotiating rates have adequate resources to develop a new indirect cost rate.



Indirect Cost Acceptance Rule (200.414c)

- Federal Agency Acceptance of Negotiated Indirect Cost Rates
 - The negotiated rates **must** be accepted by all federal agencies
 - A Federal agency may use a rate different from the negotiated rate for a class of federal awards or a single federal award only when required by federal statute or regulation, or when
 - Approved by a federal agency head or delegate based on documented justification.
 - Agencies must notify OMB of any exceptions approved by the agency head.

Getting an Approved Rate



- ☐ Must have a notice of grant, contract or other award
- ☐ Must submit notice as part of rate proposal
- ☐ Need to submit rate proposal to Cognizant Agency



MTDC Definition (200.68)

- ❑ *MTDC* means all direct salaries and wages, applicable fringe benefits, materials and supplies, services, travel, **and up to the first \$25,000 of each subaward (regardless of the period of performance of the subawards under the award).**
- ❑ MTDC excludes equipment, capital expenditures, charges for patient care, rental costs, tuition remission, scholarships and fellowships, **participant support costs** and the portion of each sub-award 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.



Frequently Asked Questions

Question: In the definition of Modified Total Direct Costs (MTDC) base, does the “regardless of the period of performance of subawards under the award” mean that if the subaward(s) to the subrecipient is made up of several separately executed funding agreements, in the course of the period of performance does each separate subaward agreement require including up to \$25k in the MTDC base for the award segment even if the scope of the subaward(s) remain the same.

Answer: Yes, if the subaward needs to be separately negotiated or renegotiated over the period of performance, this would support including an additional \$25K in MTDC for each subaward negotiation. The allowance of the \$25k is for the life of the award, or for each period of performance. Renewals of subawards may be considered, for determining the \$25k inclusion in MTDC, if they need to be formally renegotiated within the period of performance of the grant.



Frequently Asked Questions

Question: Pass through entities are expected to honor a subrecipient's negotiated F&A rate agreement, or use a 10% MTDC de minimis rate, or negotiate an F&A rate with the subrecipient.

Is it acceptable to require a subrecipient to accept a rate lower than 10% MTDC via negotiation, or in lieu of their negotiated F&A rate?

If the subrecipient requests to establish a rate via negotiation, does the pass through entity have to establish the rate via negotiation?

Answer: If the subrecipient already has a negotiated F&A rate with the federal government, the negotiated rate must be used. It is not permissible for pass through entities to force or entice a subrecipient without a negotiated rate to accept less than the de minimis rate.

MTDC Example

Total Direct Costs in our budget: \$160,000

Salaries/benefits: \$ 95,000

Supplies: \$ 5,000

Subawards under \$25k \$ 25,000

Subawards over \$25k: \$ 20,000

Capital Equipment: \$ 10,000

Participant Support Costs \$ 5,000

Modified Total Direct Costs:

= \$160,000 - \$10,000 - \$20,000 - \$5,000

= \$125,000 MTDC * 20% = \$25,000 (IDC)

Example of an Indirect Rate Agreement

The rates approved in this agreement are for use on grants, contracts and other agreements with the Federal Government, subject to the conditions in Section III.

SECTION I: INDIRECT COST RATES

RATE TYPES: FIXED FINAL PROV. (PROVISIONAL) PRED. (PREDETERMINED)

EFFECTIVE PERIOD

<u>TYPE</u>	<u>FROM</u>	<u>TO</u>	<u>RATE (%)</u>	<u>LOCATION</u>	<u>APPLICABLE TO</u>
FINAL	01/01/2016	12/31/2016	53.00	All	All Programs
PRED.	01/01/2017	12/31/2019	53.00	All	All Programs
PROV.	01/01/2020	12/31/2021	53.00	All	All Programs

*BASE

Total direct costs excluding capital expenditures (buildings, individual items of equipment in excess of \$5,000; alterations and renovations), that portion of subaward in excess of \$25,000, and patient care costs.

Extension Rule (200.414g)

■ Allows a one-time extension of Federally negotiated F&A rates for up to four years

☐ Subject to the review and approval of the cognizant agency for indirect costs.

☐ If an extension is granted the non-Federal entity may not request a rate review until the extension period ends.

☐ At the end of the 4-year extension, the non-Federal entity must negotiate a new rate.

☐ Subsequent one-time extensions (up to four years) are permitted if a renegotiation is completed between each extension request.



Sounds kinda like
my tax return...

Types of Indirect Rates

- Provisional rate
 - Temporary rate for funding until final rate approved
- Fixed rate with carryforward
 - Rate that is fixed with provisions for future periods to raise or lower depending upon actual results
- Predetermined rate
 - For research and development contracts



Provisional Rate

*“A provisional indirect cost rate is a **temporary** rate established for a given period of time to permit funding and reporting of indirect costs pending establishment of a final rate for that period.”*





Potential Problem With Provisional Rates

Provisional negotiated rate - 2018	19%
MTDC base – 2018	\$1,000,000
Actual indirect costs recovery	\$ 190,000
Indirect costs - 2018	\$ 170,000
Final rate - 2018	17%
Liability - Overbilling	\$ 20,000



Higher Ed Gets Special Treatment: *Fixed Rate for Life Rule*

Appendix III C.7

- Except as provided in paragraph (c)(1) of § 200.414 Indirect (F&A) costs, Federal agencies must use the negotiated rates, must paragraph (b)(1) for indirect (F&A) costs in effect at the time of the initial award throughout the life of the Federal award. Award levels for Federal awards may not be adjusted in future years as a result of changes in negotiated rates. “Negotiated rates” per the rate agreement include final, fixed, and predetermined rates and exclude provisional rates. “Life” for the purpose of this subsection means each competitive segment of a project. A competitive segment is a period of years approved by the Federal awarding agency at the time of the Federal award. If negotiated rate agreements do not extend through the life of the Federal award at the time of the initial award, then the negotiated rate for the last year of the Federal award must be extended through the end of the life of the Federal award.
- b. Except as provided in § 200.414 Indirect (F&A) costs, when an educational institution does not have a negotiated rate with the Federal Government at the time of an award (because the educational institution is a new recipient or the parties cannot reach agreement on a rate), the provisional rate used at the time of the award must be adjusted once a rate is negotiated and approved by the cognizant agency for indirect costs.

Predetermined Rate

- ***Predetermined indirect cost rates** are **permanent** rates established for a specific future period based on an estimate of the costs for that period. Except under very unusual circumstances, this type of rate is not subject to adjustment...*
- *“Predetermined rates are established when there is **a reasonable assurance**, based on experience and a **reliable estimate** of the organizations costs, that the predetermined rate will approximate the organizations actual rate.”*





Fixed Rates (With a Carry Forward)

*“Fixed rates are indirect cost rates which have the same characteristics as a predetermined rate, except that the difference between the estimated costs and the actual costs of the period covered by the rate is carried forward as an **adjustment** to the rate computation of a **subsequent period**.”*



Carry-Forward Example

Carry-forward provision – Part I

Negotiated Fixed Rate - 2019	40%
Direct Cost Base – 2019	\$10,000,000
Actual indirect costs - 2019	\$ 4,200,000
Indirect Cost Recovery - 2019	\$ 4,000,000
Actual rate - 2019	42%
Under-recovery	\$ 200,000*

*Carry-forward is 2 years forward (2021 in this scenario).



Carry-Forward Example

Carry-forward provision – Part II

Actual indirect costs - 2021	\$4,500,000
Carry-forward from - 2019	<u>\$ 200,000</u>
Indirect costs - 2021	\$4,700,000
Direct Cost Base - 2021	\$10,000,000
Rate with Carry-forward	47%
Rate without Carry-forward	45%

Questions



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