The OMB Rule on Indirect Costs: What You Need to Know

The Office of Management and Budget's Uniform Guidance (the Omni Circular) has brought sweeping changes for nonprofits that receive federal funding. This is particularly true with the new rule requiring agencies and other entities allocating federal dollars to reimburse organizations for indirect costs (also known as administrative or overhead costs). Nonprofits need to get up to speed on their rights and responsibilities under the rule — to avoid forfeiting reimbursement dollars.

How is reimbursement determined?

The rule on indirect costs applies to new awards and additional funding on existing awards made after December 26, 2014. Under the guidance, federal agencies — and pass-through entities that allocate federal funding, including states, local governments, and nonprofit intermediaries — must reimburse nonprofit recipients for their "reasonable" indirect costs. The guidance cites several "typical examples" of indirect costs, including:

- Depreciation on buildings and equipment,
- The costs of operating and maintaining facilities, and
- General administration expenses (for example, the salaries of executive officers, and expenses related to personnel and accounting).

Nonprofits will be reimbursed for indirect costs under one of three methods: according to an existing federally approved negotiated rate, a new negotiated rate, or a default de minimis rate of 10% of the modified total direct costs.

The ability to recover part of their overhead should relieve some of the financial pressure on nonprofits that receive federal awards and allow them to carry out a program with less impact on the overall organization. By being able to charge overhead costs to the federal grant, organizations are able to build infrastructure and focus on sustaining their activities.

What should you be doing now?

Despite the clarity of the new reimbursement requirements, nonprofits may still encounter some obstacles to recovering their indirect costs. Grantors have obvious incentives not to get on board. Some might even attempt to persuade organizations to waive their ability to collect. Waivers, however, are prohibited by the guidance. Others may not be up to speed on the requirements or may reduce other line items being funded to allow for indirect costs.

It's critical that your accounting system distinguish between, and closely track, direct and indirect costs. To accomplish this goal, you might need to make adjustments to the method you're using to account for indirect costs.

You also may need to reach out to government agencies and pass-through entities to negotiate an indirect cost rate. In some cases, you might find that the default rate of 10% is higher than what you can negotiate. Organizations that have an approved negotiated rate must use that rate for all federal awards and can't opt for the default rate. If you have an existing negotiated rate, you'll need to request a one-time extension good for up to four years. If it's granted, you can't request another review during that period. At the end of the period, you'll be required to reapply for a new rate or elect the default rate of 10%.

The bottom line

The new indirect cost reimbursement rule ultimately should be a boon for nonprofits. But it may require you to make some critical decisions, including which reimbursement method to use, and potentially how to adapt your accounting system. Your financial advisor can assist with these decisions.

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