



FOLLOW-UP REVIEW • REPORT NUMBER 24-15 • DECEMBER 2024

Federal Indirect Cost Allocation & Recovery

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Why we did this review

This follow-up review was conducted at the request of the Senate Appropriations Committee. It determined the extent to which the State Accounting Office, the Governor's Office of Planning and Budget, and other state entities addressed recommendations from our August 2016 audit (Report #14-23). The performance audit evaluated the state's efforts to recover indirect costs from federal grants, including use of the Statewide Cost Allocation Plan.

About Indirect Costs

Depending on grant terms, federal funds may be used for program administrative costs and central service costs such as budgeting, accounting, and audits. These costs are referred to as indirect costs.

The federal government allows reimbursement of indirect costs but requires a process whereby indirect costs are assigned to the grant on a reasonable and consistent basis. Once assigned, state agencies can then recover indirect costs based on the grant's proportion of use.

Requesting payment for indirect costs is usually optional and generally requires the creation of an indirect cost allocation plan for submission to federal authorities for approval.

Calculating indirect costs, including those for state central services, allows for an understanding of some associated costs of government programs, which may impact budgetary decisions.

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What we found

Since our 2016 report, the Governor's Office of Planning and Budget (OPB) and the State Accounting Office (SAO) have taken few steps to address findings related to federal indirect costs, because both agencies did not concur with most of the original report's recommendations. Some state agencies managing federal grants still do not recover indirect costs. According to OPB and SAO staff, the forthcoming implementation of the state's new enterprise resource planning system (GA@WORK) should allow for tracking indirect cost recovery at a state level. However, disagreement remains regarding whether indirect cost recovery should be required, assisted, or monitored.

Centralized Approach

In the original audit, we found state agencies choosing to recover indirect costs from federal grants were independently responsible for navigating and managing the process. This decentralized approach limited efficiency and effectiveness, and we recommended designating a central entity to coordinate, monitor, and report on all recovery efforts.

There is still no entity in Georgia charged with assisting agencies in creating indirect cost allocation plans, and no agency monitors or reports on indirect cost recovery statewide. SAO creates the statewide cost allocation plan (SWCAP) every year, publishes it to its website, and sends it to state agencies, but according to staff they do not otherwise promote or monitor its use. Moreover, SAO and OPB staff question the feasibility of having a single entity in charge of coordinating the hundreds of federal awards across state agencies. However, our research identified other states that provide centralized services such as approving, monitoring, and/or reporting on state agency indirect cost allocation plans and recovery.

In their response to the 2016 report, SAO and OPB staff indicated that they had been engaged in conversations about

implementing an enterprise grant management and reporting solution for more than a year. Georgia still has no statewide grants management system, but OPB staff indicated the one being developed as part of GA@WORK will allow for more global overview of the state’s grant environment. However, if no state entity is directly charged with statewide oversight of indirect costs, it is not clear that any agency will assume the role.

Requiring Indirect Cost Recovery

In the original audit, we found that many agencies managing federal awards either did not recover indirect costs or did not maximize the recovery of indirect costs.¹ In fiscal year 2015, only 13 of 30 state agencies managing federal grants recovered indirect costs. Some federal grants do not allow for indirect cost recovery; however, not recovering allowable indirect costs leads to the state subsidizing federal grant programs and reduces the state’s control over how state funds are expended. Georgia’s spending order policy and state Constitution both address spending federal funds before state funds, but neither specifically addresses indirect costs. Therefore, our original report recommended the state consider requiring indirect cost recovery through a specific policy or statute.

In fiscal year 2023, recovery of indirect costs remained inconsistent across state agencies. Of the 30 state agencies managing federal grants, 8 were not permitted recovery based on grant terms; of the remaining 22, 10 indicated they recover indirect costs. However, it should be noted that six agencies accounted for 96% of federal expenditures for fiscal year 2023 (\$24.9 billion of \$26.1 billion), and five of these agencies recovered indirect costs. The Georgia Department of Transportation, with \$1.7 billion in federal expenditures for fiscal year 2023, did not recover indirect costs due to agency policy.² Other agencies not recovering indirect costs—excluding those not allowed to by grant terms—totaled \$622 million in federal expenditures. Federal guidelines indicate at least 10%-15% of these expenditures could be recovered if deemed eligible.³

SAO and OPB staff noted that keeping indirect cost recovery optional allows more funds to go to direct services and activities; six agencies indicated this is a reason they do not recover indirect costs. However, defining service and activity costs without including necessary indirect costs does not consider the total cost of projects and services. Alternatively, including recovering allowable indirect costs in the plan would allow agencies to create grant applications and budgets that reflect the true cost of programs and services; with this preparation, there would be no necessary reduction to services.

Three agencies indicated they do not have the resources to manage indirect cost recovery. Having a flexible policy could address these types of issues. For example, some states that require recovery allow for exceptions if agencies demonstrate the process would create hardship or be inefficient (e.g., the cost would exceed the recovery).

Requiring SWCAP

Only three surveyed agencies reported recovering indirect costs related to state central services. Grant terms may not allow these costs even when other indirect costs can be recovered. However, even if cost recovery remains optional for state agencies, the state could require the SWCAP to be used, if allowed, whenever indirect cost recovery is pursued. Again, allowing for exceptions could be prudent—SAO staff believe some agencies, in negotiating their indirect cost rates, may be able to recover more than the SWCAP allocates to them.

¹ For purposes of this follow-up report, indirect cost recovery refers to recovery of both agency and central services costs unless otherwise noted.

² Georgia Department of Transportation staff indicated that they do not recover indirect costs because they have made the decision to use 100% of federal funds on capital projects rather than administrative costs.

³ Agencies that do not have a negotiated indirect cost rate may elect to charge a *de minimis* rate, which may be up to 15% of modified direct costs. Negotiated rates may be higher than the *de minimis*, which does not require documentation and may be used indefinitely.

Maximizing Awards

Our original report left open the possibility that, instead of taking dollars away from direct services, recovering indirect costs might result in additional federal funding. Per federal grant regulations, SWCAP costs may be used as part of the state’s matching requirement, potentially replacing state or other funds used for this purpose. In such cases, the state could re-purpose the funds previously used for the SWCAP costs. Alternatively, if the federal grant is one for which the award increases when the state increases matching funds, there may be instances where the state could earn a higher award by counting both its original appropriations and the SWCAP costs as matching funds.

The possibility of increases to the state’s overall funding as a result of indirect cost recovery is uncertain. OPB staff believe some agencies already strive to maximize their matching funds by counting everything that is allowable. However, while five surveyed agencies indicated their awards could be increased by increasing the state match, one indicated it has maximized its indirect cost recovery opportunities.

Requirements in Other States

Many states may not require indirect cost recovery. In 2016, 10 of the 12 other states we reviewed required recovery. In updating this research, we examined 23 states: the original sample plus additional southeastern states and any others receiving more federal grant dollars than Georgia. Of these 23 states,⁴ only 12 had clear evidence of requiring indirect cost recovery; however, 15 states—regardless of whether they required indirect cost recovery—clearly required any agency pursuing recovery to use the SWCAP when doing so. We identified six other states that charged a state entity with assisting agencies in the creation of indirect cost allocation plans, and five also monitored and regularly reported recovery amounts.

Agency Response: *SAO and OPB management stated that in the response to the original audit, “management generally did not agree with the audit conclusions and therefore, management did not agree that action was necessary.”*

SAO and OPB management stated that “the cost of centralizing indirect costs recovery could require more staff than economically feasible, given the volume of federal awards received,” noting there “were over 5,000 lines of federal expenditures totaling almost \$30.7 billion” in fiscal year 2023. They also stated that even with a centralized approach, “agency personnel would still be accountable for an understanding of indirect cost recovery requirements (whether a centralized or decentralized approach is employed) as each grant has specific requirements and nuances.”

Although a centralized approach to managing indirect cost allocation and recovery has not been implemented, SAO and OPB management noted that their agencies provide some related services. They noted that SAO coordinates the preparation of the SWCAP, communicates SWCAP approval to each state entity, and extends training opportunities for federal awards. They also acknowledged that “while OPB does not have a designated centralized oversight division dedicated to federal grant monitoring, all budget divisions review federal award amounts and budgeted uses of those funds as part of OPB’s responsibility for reviewing and approving amendments to agency budgets.”

SAO and OPB stated that “management continues to affirm that the decision to recover indirect costs should be a choice of each grantee rather than a requirement, as many factors impacting the decision to recover these costs, including but not limited to budgetary decisions by management to maximize direct services.” In addition, they stated that “mandating all remaining agencies with limited use of federal grants redirect resources away from direct services to supplant existing administrative costs

⁴ The 2016 sample of 12 states included Arizona, Arkansas, California, Colorado, Connecticut, Florida, Michigan, North Carolina, South Carolina, Texas, Virginia, and Washington; for this report, we also reviewed Alabama, Illinois, Indiana, Kentucky, Massachusetts, Mississippi, New Jersey, New York, Ohio, Pennsylvania, and Tennessee.

could result in year-over-year variability of funding for the administrative resources needed to support all agency operations, not just the limited federal programs they oversee, as federal grant award amounts change annually or are not continued.”

They also noted that “there has not been a consistent review of the state’s SWCAP, necessitating older amounts being used, which would result in costly federal repayments.” They further identified their concern that if “SWCAP or an agency’s application of indirect cost recovery was found to be unallowable in a subsequent year, it could potentially impact multiple fiscal years of activity. Thus, the State could be liable for significant repayments and potential interest penalties for the unallowable costs, negatively impacting both the amount of service delivery the agency could have done with those funds and the use of State general funds that would need to be diverted to cover any assessed penalties and interest.”

In discussing the report’s references to the possibilities of providing hardship exceptions to potential indirect cost recovery requirements, SAO and OPB “disagree and feel that providing an exception to the use of the indirect cost requirement could be highly subjective, require annual review by a central oversight authority, and put an executive entity in the position of determining whether or not a law applies to a given entity if the General Assembly were to pass a statute requiring indirect cost recovery.”

The agencies stated that complicating attributes of Georgia’s accounting practices—for instance, that nearly every agency in Georgia has its own federal tax identifier—could make comparison to other states with centralized indirect cost recovery programs difficult.

Finally, “SAO and OPB recommend that if specific action requiring use of indirect costs were to be recommended, that a study of the actual cost savings versus the expenses be performed prior to implementing this as a requirement.”

The following table summarizes the findings and recommendations in our 2016 report and actions taken to address them. A copy of the 2016 performance audit report (#14-23) may be accessed at: [Federal Indirect Cost Allocation & Recovery](#).

Federal Indirect Cost Allocation & Recovery Follow-Up Review, December 2024

Status: 4 Findings			
Fully Addressed: 0	Partially Addressed: 3	Not Addressed: 1	No Recommendation: 0

<p>Finding 1: Georgia’s decentralized approach has limited the efficiency and effectiveness of the state’s management and recovery of indirect costs from federal grants.</p> <p>Partially Addressed – The General Assembly has not changed requirements for indirect cost recovery, and SAO and OPB staff believe a centralized approach is not feasible but GA@WORK will allow for better tracking of indirect costs.</p>	
Original Recommendations	Action Taken
1.1 The state should consider identifying a single entity responsible for the governance and coordination of the state’s recovery of federal funds for indirect costs and assist with negotiation or engagement with federal regulators.	Not Implemented – In their responses, SAO and OPB staff indicated it would not be economically feasible to implement this recommendation due to the volume and complexity of grants involved. However, no assessment has been made of the costs and benefits of this coordination to support infeasibility, and the potential benefits could outweigh the costs.
1.2 The state should consider developing a centralized technical capacity or support for agencies implementing indirect cost allocation plans, including assurances that plans are effective, compliant, and provide the largest recovery possible.	Not Implemented – As noted above, SAO and OPB staff cited issues with the economic feasibility of implementing this recommendation.
1.3 The state should consider developing a centralized monitoring and reporting function regarding indirect cost recovery efforts.	Partially Implemented – As part of GA@WORK, the state will be implementing grants functionality, which will include the capability to track indirect costs associated to grants. This functionality is not yet available, but reportedly will be available in late 2025.
1.4 The state should consider developing a statewide system for managing grants and grant accounting information.	Partially Implemented – As part of GA@WORK, the state will be implementing grants functionality, which could address this recommendation.
1.5 The state should consider developing policies and procedures directing state agencies in the effective and coordinated use of federal funds for indirect costs.	Not Implemented – We found no evidence that the state has enacted statutes or policies on indirect costs since the original report. As noted above, SAO and OPB staff cited issues with the economic feasibility of implementing this recommendation.
1.6 The state should consider routinely evaluating state cost allocation plans to ensure that plans are updated as the structure of the state and agencies change, and the maximum statewide recovery is achieved while limiting the risks of noncompliance and over-recovery.	Not Implemented – No action has been taken to routinely evaluate state cost allocation plans. In their responses, SAO and OPB indicated it was not economically feasible to do so.

Finding 2: The state could increase control and flexibility over state appropriations by improving indirect cost allocation and recovery.

Not Addressed – The General Assembly has not made additional requirements regarding federal indirect cost recovery or use of the SWCAP, and SAO and OPB staff do not believe recovery should be required.

Original Recommendations	Action Taken
2.1 To maximize state control and flexibility over state appropriations, the state should consider requiring agencies to maximize indirect cost recovery from federal grants (unless otherwise exempted) through either policy or statute.	Not Implemented – We found no evidence that the state has enacted statutes or policies on indirect costs since the original report. SAO and OPB staff do not agree with the recommendation, citing the number of factors impacting the decision to recover indirect costs, such as the decision to maximize direct services.

Finding 3: The state should ensure the maximum amount of federal funds is recovered through the use of the Statewide Cost Allocation Plan (SWCAP).

Partially Addressed – SAO staff believes the SWCAP does consider all significant, appropriate costs; SAO and OPB staff believe further action is not feasible or required.

Original Recommendations	Action Taken
3.1 The state should consider requiring all state agencies with an indirect cost allocation plan to include their agency's SWCAP costs.	Not Implemented – SAO and OPB staff do not agree with the recommendation, noting that it does not contemplate the impact on federal funds for programmatic services and may not result in any additional funding. However, the General Assembly may prefer to re-purpose appropriations spent on indirect costs or could choose to keep program services at current levels even if indirect costs are recovered. The position of SAO and OPB is that the General Assembly already has this authority.
3.2 The state should consider designating a state agency as responsible for the use, promotion, and maximization of the SWCAP.	Not Implemented – No changes have been made since the original audit. SAO compiles the SWCAP, which is published on its website and emailed to agencies, and leaves responsibility for its use to each agency.
3.3 The state should consider ensuring that all costs that can be allocated or billed to federal grants are identified and included in the SWCAP. All central service agencies should be required to participate by providing information to SAO.	Fully Implemented – According to SAO staff, only two eligible state agencies are not included in the SWCAP, both for justifiable reasons. The Office of the Inspector General is not considered significant enough for inclusion, and the Office of the Attorney General is not included due to the nature of its interaction with the federal government.
3.4 The state should consider requiring all agencies to record, monitor, and report at least annually the amount of recovered funds due to the use of the SWCAP.	Not Implemented – As noted in their responses to Finding 1, SAO and OPB staff cited concerns related to the impact on program services and economic feasibility as reasons not to act on this recommendation. However, the General Assembly may prefer to re-purpose appropriations spent on indirect costs or could choose to keep program services at current levels, and the benefits of indirect cost recovery may outweigh the costs.

Finding 4: Some state agencies may be using noncompliant methods for allocating indirect costs to their federal grants.

Partially Addressed – OPB and SAO staff believe their current practices address compliance and that further action is not feasible or required.

Original Recommendations	Action Taken
4.1 The state should consider reviewing and assessing each agency's practices related to charging costs to federal grants, especially in those agencies operating without approved indirect cost allocation plans.	Not Implemented – In its response to the original report, OPB staff stated that each agency receiving federal funds was responsible for ensuring compliance with grant requirements. Additionally, it noted that agency practices related to federal awards were and would continue to be part of the overall budget preparation function performed by OPB.
4.2 The state should consider providing oversight of federal grant compliance and emphasizing compliance in statewide policies and procedures.	Partially Implemented – As noted earlier, OPB does not intend to provide centralized oversight of grant compliance. However, SAO does reference requirements and the Compliance Supplement in the annual memo sent out relating to the Schedule of Expenditures of Federal Awards.

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