Lessard-Sams Outdoor Heritage Council

Agenda Item Memo

DATE: September 21, 2012

SUBJECT: Action: Calculating Direct and Necessary Expenses in Support of OHF Projects

Background: The law appropriating OHF funds says “Money appropriated in this section may not be spent on activities unless they are directly related to and necessary for a specific appropriation and are specified in the accomplishment plan approved by the Lessard-Sams Outdoor Heritage Council. Money appropriated in this section must not be spent on indirect costs or other institutional overhead charges that are not directly related to and necessary for a specific appropriation.” The idea behind this law is each fund source should pay its fair share of the costs created by the programs funded, including direct support service costs.

Based on this law the DNR has prepared a methodology to calculate the cost of “DNR Shared Services” and included that amount in DNR requests before the Council in a subsequent agenda item. The amounts included are:

<table>
<thead>
<tr>
<th>Request Title</th>
<th>Request Amount</th>
<th>DNR Direct Support Services</th>
<th>DSS as a Percent of Request</th>
</tr>
</thead>
<tbody>
<tr>
<td>P03 DNR WMA, SNA and NPB Acquisition</td>
<td>$14,840,300</td>
<td>$147,000</td>
<td>1%</td>
</tr>
<tr>
<td>PRE01 DNR Grassland Phase 5</td>
<td>$3,976,300</td>
<td>$329,600</td>
<td>8%</td>
</tr>
<tr>
<td>FA01 MN Forests for the Future/State Forests</td>
<td>$13,085,000</td>
<td>$100,000</td>
<td>1%</td>
</tr>
<tr>
<td>FRE01 DNR Accelerated Forest Habitat Restoration and Enhancement Program</td>
<td>$7,239,000</td>
<td>$595,300</td>
<td>8%</td>
</tr>
<tr>
<td>WA05 McGregor Marsh Wetland Protection</td>
<td>$2,396,000</td>
<td>$36,000</td>
<td>2%</td>
</tr>
<tr>
<td>WRE01 Accelerated Wetland and Shallow Lake Enhancement</td>
<td>$3,159,000</td>
<td>$215,000</td>
<td>7%</td>
</tr>
<tr>
<td>HA01 DNR Aquatic Habitat - Phase V</td>
<td>$16,895,000</td>
<td>$750,000*</td>
<td>4%</td>
</tr>
<tr>
<td>HRE03 Lower Mississippi River Habitat Partnership</td>
<td>$3,400,000</td>
<td>$14,000</td>
<td>0%</td>
</tr>
<tr>
<td>Other 1 Conservation Partners Legacy Grants Program</td>
<td>$6,028,700</td>
<td>$35,000</td>
<td>1%</td>
</tr>
<tr>
<td>Other 2 Contract Management</td>
<td>$175,000</td>
<td>$0</td>
<td>0%</td>
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</tbody>
</table>

* DNR’s proposal figures are incorrect. The correct request amount is $16,451,701 and the shared services amount is $306,701.

The purpose of this agenda item is to provide Council members with a thorough understanding of the calculations made by DNR. Based on that understanding the council might:

- Forward the upcoming recommendations to the legislature with the language shown above.
- Identify specific categories of costs and prohibit DNR from charging for them in law.
- Setting a maximum percentage that can be charged under current law as shown above.

Suggested Motion: No Suggestions

Suggested Procedure: Review DNR’s method, question DNR, Council discussion followed by a motion.

Agenda Item # 8
September 14, 2012

Dear Legacy Fund Recipients:

As required by the Laws of Minnesota 2011, First Special Session, Chapter 6, Article 5, Section 9, I am pleased to provide the attached accounting guidance and best practices to assist in the uniform accounting of legacy fund expenditure.

Please contact me if you have any questions about this report, or you may contact Michelle Mitchell at MMB, at 651-201-8025 or michelle.mitchell@state.mn.us.

Sincerely,

James Schowalter
Commissioner

Enclosures

cc: Mike Roelofs, MMB
    Kristy Swanson, MMB
    Katharine Barondeau, MMB
    Kerstin Larson, MMB
    Keith Bogut, MMB
    Mary Robison, MMB
    Michelle Mitchell, MMB
    Ryan Baumtrog, MMB
Executive Summary

Background:
Laws of Minnesota 2011, First Special Session, Chapter 6, Article 5, Section 9, requires that “the commissioner of management and budget shall finalize guidance and best practices to assist state agencies in uniformly accounting for their expenditure of legacy funds.” The need for this guidance arose, in part, from agencies’ confusion about how to comply with the requirement that legacy fund expenditures be “direct and necessary for a specific appropriation.” Some agencies have interpreted the requirement to mean that they must exclude legacy funds from their indirect cost allocations, thereby subsidizing the administration of legacy funds programs with other state dollars.

Key Points:
Agencies are responsible for the efficient and appropriate use of legacy dollars. In MMB’s view, the “direct and necessary” requirement is intended to promote efficient and effective use of legacy fund dollars to maximize program dollars and subsequent outcomes for all Minnesotans. This goal is not unique to legacy fund dollars: efficient administration should be a goal with all state spending. The concept of “direct and necessary” is similar to the federal concept of needed, reasonable, and consistent, which guides states’ use of federal dollars. Ultimately, agencies are responsible for the efficient and appropriate use of legacy dollars, as well as documenting and defending their legacy fund expenditure.

State law and policy require all state funds pay their fair share of administrative costs.
MS 16A.127, Subd. 3, and MMB policy, require agencies to reimburse the general fund for all statewide indirect costs, and for the portion of agency indirect costs attributable to recoveries of general fund expenditures. It is reasonable and appropriate to expect the legacy funds to pay for the administration of legacy fund programs, rather than subsidizing said programs with other state dollars. Additionally, federal rules require indirect costs be allocated uniformly. If the legacy funds were excluded from an agency’s indirect cost allocation while federal funds were included, the agency is possibly in violation of said rules, and could be at risk of losing their federal funding.

The “direct and necessary” requirement does not prohibit the use of indirect cost billing for necessary administrative costs when that is the most efficient mechanism.
An example of a necessary administrative cost that is not amenable to direct billing is photocopies. In order to direct bill photocopies to a particular program or fund, tracking hardware would need to be installed on all copiers, staff would need to enter the correct code during each use, as well as aggregate and bill total copying charges at the end of the period. While such a system would provide a clear tie to how many copies were produced for a particular legacy fund, it would cost both time and money to implement, operate, and maintain such a system. In this example, the most efficient billing method is an indirect allocation. In general, direct billing is the preferred method provided it is the most efficient; if not, an indirect allocation should be used.

Agencies can use federal policy as a guide for understanding allowable legacy fund expenditure.
Agencies can use Federal OMB Circular A-87, Attachment B, for further guidance on allowable legacy fund expenditures as well as federal requirements on indirect cost allocation plans. This policy provides a time-tested and generally accepted standard for understanding allowable costs. OMB Circular A-87, Attachment B, lays out several types of costs and the extent to which they are allowable. The main driver of an allowable cost is whether it is necessary for the particular award, just as legacy fund allowable costs should be necessary for the legacy programs they are supporting.
Laws of Minnesota 2011, First Special Session, Chapter 6, Article 5, Section 9, requires that “the commissioner of management and budget shall finalize guidance and best practices to assist state agencies in uniformly accounting for their expenditure of legacy funds. The commissioner shall make this information available to all state agencies identified in this act.” The following accounting guidance is provided in compliance with this requirement.

This guidance also addresses questions about allowable administrative costs in light of the Office of the Legislative Auditor’s (OLA’s) recommendation in their November 2011 Legacy Amendment Evaluation Report that Minnesota Management and Budget (MMB) “should develop policies on allowable administrative costs for programs, projects and activities supported with money from legacy funds.”1 The OLA further stated that what is needed is a framework of principles, policies, and procedures. They specifically suggest that MMB follow the process used by the Department of Administration, Office of Grants Management, in developing standard grants management policies and procedures. MMB agreed with this recommendation and worked with agencies to develop this guidance to address the concerns of the OLA, the legislature, agencies, and constituents. We engaged agencies in creating this document by gathering information on current practices and areas of concern, convening interagency discussions on the most relevant topics, and asking for feedback on guidance drafts.

Agencies and sub-grantees that have received legacy fund appropriations have expressed confusion about how to comply with legal requirements intended to minimize the use of legacy dollars for administrative purposes. Current law requires that all legacy fund expenditure be “direct and necessary for” the specific appropriation. Part of agencies’ confusion comes from the use of the word “direct” as part of this requirement. A direct expenditure is a well-defined and commonly used accounting term that describes how expenditures are billed and tracked. The terms “direct” and “indirect” describe different billing mechanisms, and do not refer to the nature of the expense. For example, rental cost can be either direct billed or indirectly allocated. Some agencies have interpreted the “direct and necessary for” requirement to mean that they must exclude legacy funds from their indirect cost allocations. These agencies have consequently subsidized legacy fund programs with general funds or other state dollars.

In MMB’s view, the “direct and necessary” requirement is intended to promote efficient and effective use of legacy fund dollars: The language clearly implies the need for agencies to document and defend their legacy fund expenditure as needed, reasonable, consistently applied, and rationally allocated. However, it should not prohibit the use of indirect cost billing for necessary administrative costs when that is the most efficient mechanism, nor does it require agencies or sub-grantees to subsidize administrative costs associated with legacy fund programs with other sources of funding. It is reasonable to expect legacy fund programs to pay their fair share – and only their fair share – of agency administrative costs.

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BACKGROUND ON LEGACY FUND USE RESTRICTIONS

Administrative costs are part of the cost of doing business for all organizations, whether they are in the public, non-profit, or private sectors. Since the passing of the legacy amendment in 2008 and its subsequent implementation, the legislature has tried to limit the use of legacy funds for administrative expenses. This goal is not unique to legacy fund dollars: efficient administration should be a goal with all state spending, so that on-the-ground program dollars can be maximized.

The term “administrative costs” is not a universally defined accounting term. It is difficult to universally define the term “administrative costs,” because the nature of a cost depends on its context. For example, legal services may be considered an administrative cost in many instances, but these services would be a program cost in the case of a public defenders program. Although there are always exceptions, common examples of administrative costs include: 2

- Accounting and Financial Services
- Clerical Support
- Executive Personnel (such as Commissioners)
- Facilities Management
- General Office Equipment and Supplies
- Human Resources
- Information Technology
- Insurance
- Legal Services
- Purchasing
- Rent / Lease
- Security

The legislature has used different approaches to try to limit agency and sub-grantee use of legacy funds for administrative costs. In 2009 and 2010, the legislature placed percentage caps on administrative expenses in select appropriations. For example, in 2009 the legislature appropriated $4 million dollars in Outdoor Heritage Fund money to the Department of Natural Resources (DNR) for a conservation partners grant program. Up to 6.5% of this appropriation could be used by DNR for their administration of the grant. In the same year, recipients of Arts and Cultural Heritage Funds such as the Department of Education, Minnesota Historical Society, and the Department of Administration, were limited to using up to 2.5% of their grant appropriations for administration of those grants. For those appropriations that have percentage caps in place, agencies are responsible for defining the range of their administrative expenses, working within the percentage cap, and defending their use of funds to internal and external stakeholders, including auditors, the legislature, and the public.

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2 A very similar list also appears in the Office of the Legislative Auditor’s November 2011 Legacy Amendment Program Evaluation Report cited above. Page 53.
During the 2011 legislative session, the legislature changed its approach to limiting the use of legacy funds on administration in a way that provides more flexibility for agencies. Instead of using percentage caps, the legislature required that legacy fund expenditure must be “direct and necessary for” the specific appropriation. Each article in the 2011 legacy fund bill includes the following language: “Money appropriated in this article may not be spent on activities unless they are directly related to and necessary for a specific appropriation. Money appropriated in this article may not be spent on indirect costs or other institutional overhead charges that are not directly related to and necessary for a specific appropriation.” This “direct and necessary for” requirement gives agencies increased flexibility in their use of legacy fund dollars for administration relative to the percentage cap approach. However, this requirement has caused confusion and concern amongst legacy fund recipients about how to comply with the law, and what expenditures are allowable.

The section below provides a conceptual framework for understanding allowable legacy fund costs.

PRINCIPLES FOR GUIDING ALLOWABLE COSTS

The concept of “direct and necessary” is similar to the federal concept of needed, reasonable, and consistent, which guides states’ use of federal dollars. The principles and guidelines outlined in this section are the basis for well-established federal policy that places the burden for responsible, efficient, and appropriate use of federal money on the agencies that receive those federal funds. These principles are useful as a framework for understanding allowable expenditure for legacy and other state funds, because they are designed to hold the agency accountable while still allowing needed flexibility for organizational diversity in mission and structure. These principles apply to both administrative and program costs, and whether they are treated as direct or indirect expenditures.

The three basic premises can be used as the foundation for determining allowable expenditures of legacy funds:

1. Agencies and organizations are responsible for spending legacy fund dollars in a way that is consistent with the specific appropriation or agreement.
2. Agencies or organizations receiving legacy fund dollars are responsible for the efficient and effective use of those dollars.
3. Agencies and organizations have responsibility for employing whatever form of organization and management techniques may be necessary for the efficient and reasonable administration of legacy funds given their unique staff, facilities, and background.

Implicit in these premises is the assumption that state agencies are capable of administering funds efficiently and effectively to the terms specified in the award, given their particular circumstances. Federal policies allow states the flexibility to determine both their direct and indirect costs, including administrative costs. State agencies are able to allocate those costs to their federal awards as long as the costs meet certain basic criteria. Similarly, state agencies need flexibility in determining their direct and indirect costs, and allocating those costs to the legacy funds, as long as those costs meet basic criteria. These same principles also apply to all other state funds, including other constitutionally designated funds.
These basic principles apply to all recipients of legacy funds, including agencies, grantees, sub-grantees, and contractors. Legacy grant recipients are responsible for the appropriate use of legacy dollars, just as state agencies are responsible for their use of funds. State agencies that administer legacy grants are also responsible for overseeing the grantee’s use of those dollars.

Legacy fund recipients should consider the guidelines presented in this section in determining whether or not a legacy fund expenditure is allowable.

a) Need and Reasonableness

Legacy fund recipients should consider both need and reasonableness in determining if a specific legacy fund expenditure is allowable. A cost is reasonable if it is generally considered to be ordinary, logical, and proper for the efficient administration of the legacy fund award. The cost should not exceed that which would be incurred by a prudent person, in either its nature or amount, at the time that the expenditure is made. Prices for goods and services should be consistent with fair market value prices, and administration costs should be consistent with the legacy fund recipients’ responsibility to act efficiently and effectively with state funds.

The particulars of what is considered needed and reasonable will vary greatly depending on the particular legacy fund, the agency, and the appropriation purpose. For example, booking an art gallery for an art exhibit may be considered a needed and reasonable expenditure for an Arts and Cultural Heritage appropriation supporting visual artists in Minnesota. However, booking that same art gallery for an employee recognition function would not be a necessary and reasonable expenditure as part of a Parks and Trails Fund appropriation to support local parks and trails.

Legacy fund recipients must use their best judgment and adopt a prudent mindset when considering what expenditures are both needed and reasonable for a particular legacy fund award, given the particular situation of the organization and appropriation. Agencies and sub-grantees should be prepared to defend their legacy expenditures to legislators, internal and external auditors, stakeholders, and the public.

b) Consistency

Legacy fund recipients should give expenditures consistent treatment within a legacy fund award. Recipients should refer to the same governing logic in charging and categorizing expenditures throughout the life of an appropriation or grant.

Legacy fund expenditures should be determined in accordance with generally accepted accounting principles, and tracked according to Minnesota accounting policies and procedures. Such policies and procedures are in place to ensure the consistent treatment of all state expenditure, including legacy fund expenditure. Furthermore, a cost should not be categorized as a direct expenditure to a project if a cost of the same purpose and in similar circumstances has been allocated to the award as an indirect expenditure. For example, rent could be categorized as a direct or an indirect expenditure, but not as both simultaneously.

Agencies and sub-grantees should be prepared to defend their expenditures to legislators, internal and external auditors, stakeholders, and the public.
c) Adequately Documented

Legacy fund recipients are responsible for developing and maintaining adequate documentation of their legacy fund expenditures. While the means and processes of this documentation can and should vary by organization, the resulting documentation should be sufficient to show that the need and reasonableness and consistent use criteria have been met. At a minimum, legacy fund recipients should be prepared to demonstrate to an outside party that they have a logical system in place for determining legacy fund expenditures, and that the system has been consistently applied within the organization.

d) Rationally Allocated

Legacy fund expenditures should be clearly allocable to the program. Either they should be allowable direct expenditures, as determined by the principles provided above, or they should be an allocable amount of the agencies indirect costs. Activities that benefit from either agency or statewide indirect costs will receive an appropriate allocation of those costs.

Legacy fund recipients have raised questions regarding what indirect costs can be considered “direct and necessary for” legacy fund appropriations and awards. By definition, an indirect cost cannot also be a direct cost of a program. However, indirect costs are necessary for the administration of state funds. Indirect costs can therefore be allocated to the legacy funds, just as they are to all other state funds.

The allocation of agency indirect costs to the legacy funds should meet the same basic criteria outlined above of being needed and reasonable, consistently applied, and adequately documented. Further exploration of the nature and proper allocation of direct and indirect costs is provided in the next section of this guidance document.

TYPES OF ALLOWABLE COSTS

Agencies can use Federal OMB Circular A-87, Attachment B, for further guidance on allowable legacy fund expenditures. This policy provides a time-tested and generally accepted standard for understanding allowable costs.

OMB Circular A-87, Attachment B is not meant to be exhaustive, but it lays out several types of costs and the extent to which they are allowable. The main driver of an allowable cost is that is be necessary for the particular award, just as legacy fund allowable costs should be necessary for the legacy programs they are supporting. Some types of costs are not allowable, because they are never viewed as necessary, such as the cost of alcoholic beverages, staff entertainment, lobbying, or fundraising. Other types of costs -- whether they are public relations costs, meetings, audit costs, bonding, legal costs, travel, etc. -- should be judged based on their need and reasonableness for the specific program. It is not possible to anticipate every type of cost that might arise for the variety of agencies and organizations that administer legacy funds in order to say explicitly whether or not they are allowable, so staff should use their best judgment. Necessary expenditures can be treated as either direct or indirect costs.
OMB Circular A-87, Attachment B provides guidance on several issues that have also been raised with regards to the legacy funds. For example, staff compensation costs including wages, salaries, and fringe benefits are allowable to the extent that they meet the criteria outlined above, and they are consistent with the amount paid for similar government work in other programs.

Employee benefits such as the cost of leave, employee insurance, pensions, and unemployment are allowable to the extent that they are reasonable and required by law, policy, or government-unit employee agreement.

Employee benefits in the form of regular compensation paid to employees during periods of authorized absences from the job, such as sick leave, holidays, court leave, military leave, and other similar benefits are allowed if they are established in written leave policies, the cost is equitably allocated to all related activities, including legacy programs, and the accounting basis for each type of leave is consistently followed by the government unit.

Staff costs charged to legacy funds can include all levels of staffing, including managerial staff, as long as those costs are reasonably and equitably allocated. The amount of staff compensation charged to legacy funds for wages, salary, and benefits should be reflective of their workload on legacy projects. Agencies should have checks in place to ensure that legacy funds – and all other state funds – are charged in a way that accurately reflects actual employee time. This could include staff tracking their actual time spent on legacy programs on an on-going basis, or allocating cost according to staff position descriptions. If an agency does not have a personnel time report system that can handle actual hours, a reasonable percentage of time spent on legacy activities approach could be used, and the percentage used for individual programs should be checked at least quarterly to be sure that it is accurate. If there are discrepancies found, the agencies should complete expenditure corrections and adjust position descriptions accordingly. Agencies should implement the system that is most efficient and effective for them.

Other staff costs, such as insurance and unemployment, should be considered on a case-by-case basis and should be handled in a way that the agency considers logical and defensible. Agencies can consult OMB Circular A-87, Attachment B for further guidance on allowable legacy fund expenditures.

**LEGACY FUNDS AND INDIRECT COSTS**

Much of the confusion surrounding the “direct and necessary for” requirement comes from the use of the word “direct.” “Direct” is a well-defined and commonly used accounting term, referring to direct vs. indirect cost charges. Direct expenditures are those that can be identified specifically with a particular final cost objective, whereas indirect costs are those general support costs that cannot reasonably be directly charged to an agency, program, appropriation or program. “Direct” and “indirect” describe to how expenditure is treated and tracked, not to the nature of the expense. Some administrative costs can be treated either as direct or indirect cost. For example, rent may be direct billed to a program or included in an agency’s indirect cost allocation. Regardless of whether it is treated as a direct or indirect cost, the nature and necessity of the rental cost remains the same.

Agencies face a trade-off between transparency and efficiency when determining what costs to direct bill and what costs to include in an indirect cost allocation plan. Direct billing is more transparent, but often
more administratively burdensome than an indirect cost allocation. For example, direct billing photocopies to a particular program or fund would require that hardware be installed on all copiers so that individual copies could be tracked to programs or appropriations. Staff would then need to enter the appropriate code when using the copier, and then aggregate and bill total copying charges at the end of the period. Such a system would show a clear tie between the number of copies and the amount billed to each fund. However, this system would require more time and money to implement, operate, maintain and report and, therefore, would be less efficient than including copies and printing costs in the agency’s indirect cost allocation. If these costs were included in an indirect cost plan, agency financial staff would be responsible for allocating the total cost of copies across programs and funding sources in a way that they believe is fair and equitable. Staff would also be responsible for documenting and justifying their indirect cost plan to both internal and external stakeholders. Agencies should use indirect billing methods when there are efficiencies to be gained and administrative costs are kept low. In many cases, agencies might consider their current indirect rates to be the most efficient option.

Some agencies may choose to move some costs to direct billing in response to receiving legacy funds if they wish. For example, some IT costs that are frequently included in indirect cost allocations, such as network connections, hardware, and e-mail service, could potentially be removed from the indirect cost allocation and direct billed to legacy programs, in order to show clear connection between legacy fund spending and need. However, moving entirely to direct billing would not be efficient for many organizations and, therefore, would not be consistent with the need to keep administrative costs down. It is not necessary or desirable for agencies to move entirely to direct billing in order to comply with the “direct and necessary for” requirement. Instead, legacy fund recipients are responsible for finding a balance between direct billing and indirect cost allocation that they believe is efficient, logical, and defensible given their particular circumstances, resources, and constraints.

In those cases where agencies have an indirect cost plan in place, legacy funds should be included in that indirect cost allocation. MS16A.127, Subd. 3, and MMB policy, require that agencies reimburse the general fund for all statewide indirect costs, and for the portion of agency indirect costs attributable to recoveries of general fund expenditures. This law and policy is based on the principle that it is reasonable and appropriate for all state funds to pay their fair share of administrative costs. We believe that this applies to the legacy funds just as it applies to all other state funds. Furthermore, federal policy requires that indirect costs be allocated uniformly across state and federal funds, so that the resulting indirect rate is equitable. If the legacy funds were excluded from the allocation, it would result in a higher indirect rate for those funds that were included. Federal policy prohibits federal funds from subsidizing state funding via higher indirect cost rates. Therefore, agencies that exclude legacy funds from their indirect cost allocation are possibly in violation of federal rules and could be at risk of losing their federal funding awards. Other state funds would also be subsidizing legacy fund programing if legacy funds were excluded from the allocation. Agencies should document and be willing to defend how they allocate their indirect costs in general, and how they allocate indirect cost to the legacy funds in particular.

a. General Indirect Cost Rates
When the agency or organization’s major functions benefit from indirect costs to approximately the same degree, the allocation of indirect costs can be achieved through one rate, by (1) classifying the agency’s total cost as either direct or indirect, and (2) dividing the total indirect cost pool by an equitable distribution base. The resulting rate can be used to distribute indirect cost across funds and programs, including legacy programs.

b. Multiple Indirect Cost Rates

When major functions within an agency benefit from indirect costs to varying degrees, the indirect cost can be allocated into separate cost groupings. Indirect cost can then be allocated within individual cost groupings by a base that reflects the relative use and benefits. Each cost grouping should constitute a pool of like expenses in terms of the allocation base that best measures the relative benefits provided by each function. The number of different cost pools should be limited to what is practical. The base that is used when allocating costs within a cost pool should be based on actual conditions, depending on the benefits that each group receives.

Agencies that have multiple indirect cost groupings in place should aggregate legacy funds across those cost grouping in a way that they feel is most defensible based on their function, so that the resulting indirect cost allocations are appropriate. Legacy award should not necessarily be included in the same cost grouping because they are funded by legacy dollars -- they should be grouped by major function.

c. Special Indirect Rates

In some cases, a single indirect rate for an agency or organization or a rate for each major function of the agency may not be appropriate. There may be factors that could substantially affect the indirect costs applicable to a particular program or group of programs. Such factors may include: the physical location of the work, the level of administrative support required, the nature of the resources that are used, the organizational structure used, or some combination of factors. When an award or group of awards is carried out in a way that generates significantly different indirect costs, then agencies should use a separate indirect cost pool for those awards, provided that the resulting indirect cost rate is significantly different from other rates at the agency, and the award or awards are material in amount.

Any special indirect cost rates used for a legacy award or legacy awards should be based on the same indirect cost factors described above of location, administrative support, and resources. That is, legacy funds should only be granted special indirect cost rates when merited by substantive differences in cost, just like any other state or federal award. Legacy funds should not necessarily be granted special rates because they are legacy funds. It is appropriate for legacy funds to pay indirect rates based on their actual costs.

d. Statewide Indirect Costs

MS16A.127 defines both statewide and agency indirect costs. Statewide indirect costs refer to all general fund expenditures made by any state agency attributable to providing general support services
to any other state agency. For example, the cost of the statewide accounting system and financial support to agencies provided by MMB, as well as the building maintenance services as provided by the Department of Administration, are all part of statewide indirect costs. These costs are part of the full cost of doing business. State programs cannot function, for example, without the presence of the state accounting system.

MS16A.127 charges MMB with calculating and allocating statewide indirect costs in a fair and equitable manner. Agencies are then responsible for reimbursing the general fund for the portion of their indirect cost attributable to non-general funds. It is through this process that non-general funds pay for a “fair share” of the cost of statewide administrative services. In the absence of this process, the general fund would be made primarily responsible for the administrative costs of non-general fund programs, thereby putting the general fund in the position of subsidizing the costs associated with other funds.

MS16A. 127 does allow MMB to issue waivers from the reimbursement requirement of statewide indirect costs in particular circumstances. The circumstances in which a waiver can be granted are limited because such a waiver leaves other state funds responsible for paying that portion of the agencies’ indirect costs.

MMB has granted some legacy funds a waiver from paying statewide indirect in the past, where specifically prohibited by law. Outdoor Heritage appropriations from 2010 were granted a waiver based on the requirement in Laws of MN 2010, Chapter 261, Article 1, Section 2, Subd. 7, that “money appropriated in this section must not be spent on indirect costs or other institutional overhead charges.” This language clearly exempts the Outdoor Heritage Fund from paying indirect costs in this year, such that it should not reimburse the general fund for the cost administering Outdoor Heritage projects.

MMB does not consider the direct and necessary language sufficient to require a waiver from statewide indirect costs. If the legislature would like to exempt the legacy funds from paying statewide indirect costs, they should clearly exempt them within the law. Agencies are expected to pay statewide indirect costs for their administration of legacy fund programs.

CONCLUSION

This guidance focuses on implementing the requirement that legacy fund expenditures be “direct and necessary for the specific appropriation.” This requirement is intended to ensure that agencies maximize program dollars and subsequent outcomes for all Minnesotans. However, this requirement does not prohibit agencies from paying for the full cost of administering legacy programs. Under law and state policy, all state funds, including the legacy funds, should pay their portion of administrative costs, and not be subsidized by the general fund or other dedicated funding sources. That is, the legacy funds can and should pay their fair share – and only their fair share -- of organizational costs. Rather than requiring agencies and organizations to subsidize their legacy-funded programs with other funds, the “direct and necessary for” language requires that organizations adequately document and reasonably defend their legacy fund expenditures.
# APPENDIXES

*Appendix 1: Examples of legal language that has placed limits on the use of legacy funds for administration:*

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<tr>
<th>Law</th>
<th>Examples of Administrative Caps or Other Limits</th>
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<tr>
<td>Laws of MN 2009, Chapter 172</td>
<td>Administrative percentage caps placed on specific appropriations, such as:</td>
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<td></td>
<td>Article 1, Section 2, Subd. 2b, to DNR for the Green Corridor Legacy Program: “No more than 5% of this appropriation may be spent on professional services directly related to this appropriation’s purposes.”</td>
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<td>Article 2, Section 6(a), to BWSR for the Conservation Easements RIM Program: “Up to 5% may be used for administration of this program.”</td>
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<td>Article 2, Section 6(b) and 6(c), to BWSR for grants to local watershed districts: “Up to 5% may be used for administering the grants.”</td>
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<td>Article 3, Section 2, Subd. 2(d), to DNR for grants to parks and trails of regional significance: “Up to 2.5% of this appropriation may be used for administering the grants.</td>
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<td>Article 4, Section 2, Subd. 2(b)(4), to the State Arts Board for grants: “Up to 3% of the money to administer grant programs, deliver technical services, provide fiscal oversight for the statewide system and to ensure accountability of the state’s resources.”</td>
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<td>Laws of MN 2010, Chapter 361</td>
<td>Further limits placed on the use of Outdoor Heritage Funds for “indirect and institutional overhead” charges. Article 1, Section 2, Subd. 7, states of the Outdoor Heritage appropriations in this year that “money appropriated in this section may not be spent on activities unless they are directly related to and necessary for the specific appropriation. Money appropriated in this section must not be spent on indirect costs or other institutional overhead charges.”</td>
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<td>Additional Clean Water Fund appropriations to BWSR included 5% caps on administrative expenses, just as they were included on a number of the agencies 2009 appropriations.</td>
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<td>Laws of MN 2011, Special Session 1, Chapter 6</td>
<td>Language limiting the use of legacy funds for administrative change to the requirement that all expenditure from all four legacy funds be “direct and necessary for a specific appropriation.” The full language is as follows: “Money appropriated in this article may not be spent on</td>
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Money appropriated in this article may not be spent on indirect costs or other institutional overhead charges that are not directly related to and necessary for a specific appropriation.”

Appendix II: Indirect Cost Calculations

Agencies are not required to use an indirect cost allocation. However, where applicable, state and federal policy requires that indirect costs be allocated out across all funds, so that the resulting indirect cost rate is equitable. If an agency that has an indirect cost plan in place chooses to exclude legacy funds from the cost allocation, they would be in violation of both federal and state policy requiring all funds to pay their fair share – and only their fair share – of agency costs.

Agencies that have indirect cost plans in place should include necessary legacy fund shared administrative costs in their indirect cost allocation.

1. “Indirect cost rate proposal” means the documentation prepared by a government unit or subdivision thereof to substantiate its request for the establishment of an indirect cost rate. Federal and state policy require that this documentation contain:
   
   I. A description of the indirect cost rate, including subsidiary work sheets and other relevant data, cross referenced and reconciled to the financial data.

   II. A copy of the financial data (financial statements, comprehensive annual financial report, executive budgets, accounting reports, etc.) upon which the recovery rate is based.

   III. An explanation of the direct base used to allocate agency indirect costs.

   IV. A chart showing the organizational structure of the agency during the period for which the plan applies, along with a functional statement(s) noting the duties and/or responsibilities of all units that comprise the agency.

2. “Indirect Cost Rate” is a device for determining in a reasonable manner the proportion of indirect costs each program should bear. It is the ratio (expressed as a percentage) of the indirect costs to an indirect cost base.

3. “Indirect Cost Pool” is the accumulated costs that jointly benefit two or more programs or other cost objectives.

4. “Base” means the accumulated direct costs used to distribute indirect costs across the agency. Normally, this is either total direct salaries and wages or total direct costs less any extraordinary or
distorting expenditure. The cost base selected should result in each award bearing a fair share of the indirect costs in a reasonable relation to the benefits received from the costs.

Indirect Cost Rate = Indirect Cost Pool / Base

Any exclusion from the base should be done to eliminate distorting expenditures, as stated in the definition. A common example of a distortionary expenditure would be pass-through grants, less the cost of administering those grants. Pass-through appropriations are distortionary because large portions of the money go out the door to other organizations. Some legacy dollars are appropriated to agencies like the DNR and Department of Administration for pass-through grants to other organizations, and therefore should be excluded from the indirect cost base. However, legacy dollars that are used for programs administer grants and agency programs should remain in the indirect cost base. Other examples of possible exclusions from the base include capital expenditures, payments to individuals, or any unallowable costs as discussed above.