

# Harris County Auditor's Office



## MEMORANDUM

To: David Berry, County Administrator

From: Mike Post, Harris County Auditor *MP*  
Errika Perkins, Chief Assistant County Auditor- Audit Division *EP*

CC: Lina Hidalgo, County Judge  
Rodney Ellis, Commissioner Precinct 1  
Adrian Garcia, Commissioner Precinct 2  
Tom Ramsey, Commissioner Precinct 3  
R. Jack Cagle, Commissioner Precinct 4  
Daniel Ramos, Executive Director, Office of Management and Budget

RE: Countywide Cost Allocation and Indirect Cost Rate Review

Date: April 20, 2023

## EXECUTIVE SUMMARY

At the request of Mr. David Berry, County Administrator, the Audit Division performed a consulting engagement of agreed upon procedures to review federal and state indirect cost allocation processes for the 12-month period ending September 30, 2022. The engagement's scope was to evaluate the following objectives:

### 1. Countywide Cost Allocation Processes

- Select a judgmental sample of federal and state grants to determine if consistent processes are in place for allocation of overhead.

### 2. Accurate and Appropriate Allocation of Indirect Costs

- Determine if indirect costs were applied accurately and appropriately for a judgmental sample of federal and state grants.

### 3. Completeness and Accuracy of Grant Systems

- Review PeopleSoft's grants module to verify if key grant data elements are captured consistently and accurately for reliable operational reporting.

**Recommendations** for cost allocation and indirect cost rates include:

- 1.1 Develop a grants management policy to govern the application of Countywide indirect cost rates.
- 2.1 Maximize grants fund utilization while remaining compliant with program objectives and contract terms.
- 2.2 Develop standard training for departmental employees with grants management responsibilities.
- 3.1 Improve grant data integrity by utilizing PeopleSoft for grant project management.

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## BACKGROUND

Per 2 CFR § 200.413(a), Direct costs are those costs that can be identified specifically with a particular final cost objective, such as a federal award, or other internally or externally funded activity, or that can be directly assigned to such activities relatively easily with a high degree of accuracy. Costs incurred for the same purpose in like circumstances must be treated consistently as either direct or indirect costs.

Per 2 CFR § 200 Appendix VII, Indirect costs are those that have been incurred for common or joint purposes. These costs benefit more than one cost objective and cannot be readily identified with a particular final cost objective without effort disproportionate to the results achieved. After direct costs have been determined and assigned directly to Federal awards and other activities as appropriate, indirect costs are those remaining to be allocated to benefitted cost objectives. A cost may not be allocated to a federal award as an indirect cost if any other cost incurred for the same purpose, in like circumstances, has been assigned to a federal award as a direct cost. Most grant contracts identify whether an indirect cost rate has been agreed upon between the County and the granting agency or if an indirect cost is allowable. If a contract does not explicitly state that an indirect cost rate has been agreed upon, 2 CFR 200.414 subsection F allows for a de minimis rate of up to 10% of direct costs incurred limited by the remaining grant balance.

Specific methods for allocating indirect costs and computing indirect cost rates along with the conditions under which each method should be used are described in 2 CFR 200 Appendix VII C subsections 2, 3 and 4. The methods include the simplified method, multiple allocation base method, and special indirect cost rates.

The County engaged MGT of America, Inc. (MGT) to prepare the Indirect Cost Allocation Plan - Full Cost Basis using actual expenditures incurred in FY2021 (March 1, 2020, to February 28, 2021). The Plan identified Countywide indirect costs of supporting departments, the allocation of indirect cost to operating departments, and the indirect cost rate. County departments have developed an individual approach for applying indirect cost towards federal and state grants.

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## RESULTS

### OBJECTIVE 1: Countywide Cost Allocation Processes

**OBSERVATION 1.1:** Auditors determined which County departments received and expended the most federal and state grants within the County. We met with them to obtain an understanding of any indirect cost processes in place and the department's methodology for determining whether indirect cost is appropriate or feasible.

The following departments were interviewed during the engagement: Community Services Department (CSD), Public Health Services (PHS), Sheriff's Office (HCSO), and Flood Control District (FCD).

- CSD does not charge indirect costs for the federal or state grants that they administer. Instead, costs are allocated directly to programmatic administration, which has been built into the majority of CSD's grant contracts.
- PHS uses a preapproved indirect cost rate calculated by an Indirect Cost Rate Proposal obtained from MGT, which analyzes the department's administrative expenditures as they relate to grants administration. PHS does not always charge the full indirect cost rate. Awards are analyzed to determine what funds are needed on the programmatic side to achieve the program objectives. Based on the approved rate and assessment of programmatic needs, PHS determines how much indirect cost is available to charge to the grant. There are cases when PHS forgoes indirect cost, including when grant budgets are predetermined by the granting agencies.

- HCSO infrequently charges indirect costs to grants. Grant funds typically go towards programmatic expenditures, with administrative costs being paid by general funds.
- FCD typically receives grants that do not allow for indirect costs. For grants that allow for indirect costs, the department believes that the entire grant should go to completing the grant objectives, and if indirect costs were included, program expenditures would need to be supplemented.

Each department has determined their own methodology for applying, or not applying, indirect cost. Departments interviewed shared concerns around indirect costs reducing available funding that could otherwise be applied to the programmatic purpose of the grant.

**RECOMMENDATION 1.1:** The Office of County Administration or the Office of Management and Budget should create a Countywide grants management policy to include guidelines on the development and application of indirect cost rates. The grants management policy should be submitted to Commissioners Court for approval to govern their authorization of grant applications. The County should also explore utilizing indirect costs to satisfy grant matching requirements, when applicable.

## **OBJECTIVE 2: Accurate and Appropriate Application of Indirect Costs**

**OBSERVATION 2.1:** Auditors selected 25 grants with a budgeted award amount totaling approximately \$203.2 million across multiple Harris County departments and calculated the indirect cost base using the budget amount and expenditures recorded within PeopleSoft. Based on the data within PeopleSoft, approximately \$4.65 million in potential indirect cost underutilization was identified when applying the de minimis 10% rate. The estimated potential indirect cost calculation was based on the requirements in the applicable grant agreements.

**RECOMMENDATION 2.1:** To help facilitate full grant utilization, any indirect cost eligible grant with a projected remaining balance could elect to allocate overhead expenditures on a pro rata basis at the default 10% de minimis rate, per 2 CFR 200.414(f) to recoup administrative costs of the grant.

Additionally, departments should perform ongoing monitoring and analysis to determine potential underutilization of grants with a remaining balance. Departments that lack grant support resources could benefit from Countywide support or guidance on maximizing their grant dollars and maintaining compliance with grant terms.

**OBSERVATION 2.2:** Auditors selected a sample of 10 indirect cost grant expenditures to test for accuracy and completeness of the application of the indirect cost rate. For 2 of the 10 samples (20%), the indirect cost expenditures were calculated incorrectly; however, no corrective action is needed because the indirect cost expenditures charged fell below the contract agreement threshold.

**RECOMMENDATION 2.2:** Standardized training should be developed for employees with grant management responsibilities to understand compliance with 2 CFR 200, including the Compliance Supplement.

## **OBJECTIVE 3: Completeness and Accuracy of Grant Systems**

**OBSERVATION 3.1:** The Office of Management and Budget (OMB) uses a project management software called GrantMaster to track grants received by Harris County. Auditors reviewed and compared the data within PeopleSoft to GrantMaster for a sample of grants to determine whether the information completely and accurately represented the population of federal and state grants available to County departments.

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We determined that 4 of the 29 (14%) grants selected for comparison had award amounts within GrantMaster that conflicted with budgeted amounts in PeopleSoft.

**RECOMMENDATION 3.1:** OMB should work with the Auditor's Office Accounting Division to determine how to best utilize PeopleSoft as the financial system of record (SOR) to capture the necessary grant data and avoid duplication of entry and inconsistencies with GrantMaster. If OMB continues utilizing GrantMaster, a reconciliation control should be implemented to ensure consistency of data in GrantMaster to Peoplesoft.

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***Internal Audit Standards***

We conducted our engagement in accordance with the International Standards for the Professional Practice of Internal Auditing (Standards). The Standards require that we comply with the Code of Ethics and obtain reasonable assurance that significant risks to the activity are minimized to an acceptable level.