

INDIRECT COST ALLOCATION PLANS
FOR IDAHO'S
LOCAL EDUCATION AGENCIES



Marilyn Howard, Ed.D
State Superintendent of Public Instruction
January, 2003

INTRODUCTION

Applications for grants usually involve a request for reimbursement of both direct and indirect costs. OMB Circular A-87 contains provisions for determining indirect cost rates for both grantees and subgrantees of federal grants.

Local education agencies (LEAs) are not required to obtain and use an indirect cost rate; however, if they fail to do so, they will not be allowed to recover any indirect costs related to federal grants and contracts. Put plainly, to recover any indirect costs for the administration of federal grants, a LEA must have an approved indirect cost rate.

INDIRECT COST PROPOSALS

An approved indirect cost rate is a simplified way of determining a fair share of indirect costs for federal grants, which are acceptable to federal grantor agencies. In theory, all such costs can be charged directly. However, using an indirect cost rate is often more efficient and practical. The Idaho Department of Education has, in cooperation with the US Department of Education, developed an indirect cost plan to be used by LEAs in Idaho. In addition, the Idaho State Department of Education has been delegated the authority by the US Department of Education to review indirect cost proposals and to approve the indirect cost rates for the LEAs.

An indirect cost rate is a reasonable means of determining the percentage of allowable general administrative expense that each Federal grant should bear. Generally, an indirect cost rate is the ratio of total indirect costs to total direct costs, based on the LEA's actual expenditures, exclusive of any extraordinary or distorting expenditures such as capital outlay and debt service. Expenditures for the second preceding fiscal year are used when completing the indirect cost proposal for a given fiscal year. For example, expenditures for FY 2001-2002 will be used to compute the restricted indirect cost rate for FY 2003-2004.

An indirect cost rate does not increase the grant. It allows a portion of the total grant to reimburse the school district for indirect costs of centralized activities such as accounting, payroll, personnel, etc.

The source of information used to determine an indirect cost rate is the LEA's official Annual Financial Report and the detail that comprises that report. Therefore, it is essential LEAs classify expenditures uniformly and consistently in accordance with the Idaho Financial Accounting Reporting Management System (IFARMS) Manual. Similar types of expenditures must be consistently coded to the same accounting classification. Expenditures that are identified as indirect costs may not also be included as direct costs. A transfer of funds from one fund to another should not be considered an expenditure in itself. All expenditures detailed on the Annual Financial Report must have been made and the LEA must maintain records supporting them.

The Office of Management and Budget's Circular A-87 sets forth cost principles and standards for determining the allowable cost of federally funded grants administered by state and local governments. The most recent revision of OMB Circular A-87 is available on the Internet at <http://www.whitehouse.gov> (once at the website, do a search

for Circular A-87) and is the basis for the development of indirect cost allocation plans and rates. The plans described here are based upon those principles.

OMB Circular A-87 requires that all funds of a district be included in the preparation of an indirect cost plan. These costs are derived from the general fund, special revenue funds, and any other applicable funds for the administration of the district.

If indirect costs are determined within a given program, but not claimed for the grant or contract, such amount may be used as "local effort", if local matching funds are required.

The indirect cost plans for LEA's establish the maximum discounted restricted rates for a given year. After final calculations of the indirect cost rate, the rate is discounted by 5%. For example, if the indirect cost rate calculated for a certain year was 4.21%, this rate would then be discounted by 5%. The approved restricted indirect cost rate would be 4.0% (4.21% x 95%, rounded to one decimal place). Once calculated, this rate becomes the discounted restricted indirect cost rate for that LEA for that one-year period. The reason for the 5% discount is so that the rate will not be subjected to carry-forward or carry-back adjustments.

A local education agency may elect to claim indirect cost at a rate less than that approved rate; however, in no instance may it use a rate for a grant or contract that exceeds the approved rate.

AUDIT REQUIREMENTS

1. General Requirements

The classification of expenditures must be in conformance with the Idaho Financial Accounting Reporting Management System (IFARMS) Manual. Failure to comply with the classification of expenditures as required may result in Single Audit questioned costs related to indirect cost recovery.

2. Additional Documentation - Indirect Costs

Costs classified as indirect should be supported by worksheets and retained for audit. Inadequate documentation may result in an audit finding requiring repayment of indirect costs incorrectly recovered by a school district.

3. Additional Documentation - Excluded Costs

Schedules or other records should be maintained that document the reporting of all expenditures classified as excluded costs. Excluded costs include capital outlay, debt service and interest, and other expenditures, such as contributions and donations, bad debts, contingencies, entertainment, fines and penalties, judgments, fund raising, investment counseling for non-federal funds, losses on property, lobbying, operating transfers, and residual equity transfers. Inadequate documentation may result in an audit finding requiring repayment of indirect costs incorrectly recovered by a school district.

TYPE OF PLAN AND RATE: RESTRICTED AND UNRESTRICTED

Idaho's Indirect Cost Plan has been approved by the US Department of Education for use by the Idaho Department of Education when issuing indirect cost rates to LEA's. The "Restricted Indirect Cost Rate" is for use with grants subject to the "supplement but not supplant" restriction. The unrestricted indirect cost rate is for use with grants not subject to the "supplement but not supplant" restriction.

RESTRICTED

Most of the federal grants that the LEA obtains through the Idaho Department of Education are of the "restricted" type.

1. Restricted rates apply to grants that are made under federal programs with supplement and in no case supplant requirements. This means the funds are for support in addition to state and local funding. Such amounts are intended to supplement, but in no way replace, state and local funds.
2. Restricted grants include only indirect costs of administrative and fixed charges as defined below.

UNRESTRICTED

Unrestricted rates apply to grants not subject to the supplement but not supplant restriction.

1. Indirect Costs – Expenditures for the office of the superintendent in addition to operations and maintenance of plant are classified as indirect costs when calculating an unrestricted rate. All other costs are classified the same as with the restricted rate calculation
2. Direct Costs, Disallowed Costs, and Excluded Costs are also classified the same as with the restricted rate calculations.

DEFINITIONS

1. Indirect Costs

Indirect costs are those costs of a general nature which are not readily identifiable with the activities of the grant but are, nevertheless, incurred for the joint benefit of those activities and other activities or programs of the organization.

More precisely, OMB Circular A-87 defines indirect costs as those costs which meet the following criteria:

- a. Incurred for a common or joint purpose benefiting more than one cost objective, and,
- b. Are not readily assignable to the cost objectives specifically benefited.

Administrative indirect costs consist of the salaries and other expenses for people who are engaged in administrative activities that benefit the entire LEA. Those activities that are limited to one school, subject, or phase of operation are not indirect costs.

Generally, salaries and expenses for accounting, budgeting, payroll, personnel management, purchasing, employee relations, labor negotiation contracts, mailrooms, computer networks, or data processing operations are examples of services which typically benefit several activities and programs for which costs may be claimed by means of an indirect cost rate. Auditing expenses may also be included if the audit was performed in accordance with the Single Audit Act (Circular A-128). Costs related to the direction and supervision of such areas as instruction and guidance, attendance, transportation, community services, and student services are not indirect costs. Costs for these functions are considered direct costs. For example, the business manager, accounting manager, and accounting section are included as administrative indirect costs, but the director of transportation would be classified as a direct cost. Expenditures identified as indirect costs cannot also be classified as direct costs.

Other costs which are not indirect costs include, but are not limited to, all expenditures for the school board, contributions and donations, bad debts, contingencies, debt services and interest, stipends, capital outlay, entertainment, fines, and penalties.

The superintendent, the superintendent's secretary, and expenses related directly to the operation of the superintendent's immediate offices are considered direct costs when calculating the restricted rate. Similarly, an individual principal, a principal's secretary, and the expenses related to the operation of these immediate offices are not included in indirect costs but are considered to be direct costs for rate computation purposes.

2. Direct Costs

A direct cost is one that is incurred specifically for one activity and can be identified specifically with that activity. These costs may be charged directly to grants, contracts, or to other programs.

3. Unallowed Costs

OMB A-87 has classified certain costs as unallowable, meaning federal funds cannot be used for these purposes. These are costs directly attributable to governance. For formula computational purposes, these costs are combined with direct costs.

4. Excluded Costs

Certain items of costs are classified in OMB Circular A-87 as extraordinary or distorting expenditures and are excluded from the computation of the indirect cost rate. Excluded costs in this category include capital outlay, debt service and interest, and other expenditures, such as contributions and donations, bad debts, contingencies, entertainment, fines and penalties, judgments, fund raising, investment counseling for non-federal funds, losses on property, lobbying,

operating transfers, and residual equity transfers. For formula computational purposes, these costs are excluded from the rate computation.

LIMITATIONS ON THE RECOVERY OF INDIRECT COSTS

Three major limitations affect how much indirect cost may be recovered:

1. The rate negotiated with the Idaho Department of Education is the maximum allowable indirect cost for any federal program in which the LEA participates. Federal law or grant conditions may further limit the amount of indirect costs or the indirect cost rate. Some grants may prohibit any recovery of indirect costs.
2. Recovery of indirect costs on grants is subject to the availability of funds. Most restricted grants are allocated to the State as a block grant in which each LEA is entitled to a maximum grant amount. The total direct costs plus indirect costs cannot exceed the maximum entitlement.
3. Indirect costs are recovered only to the extent of direct costs incurred. **The indirect cost rate is applied to the direct cost amount expended less capital outlay and subgrants, not to the grant award.**

PERIOD FOR WHICH RATES ARE APPLICABLE

A restricted indirect cost rate issued by the Idaho Department of Education is valid for a specific fiscal year. The rate is valid from July 1 through June 30 of the applicable fiscal year. To recover indirect costs, the LEA applies the indirect cost rate in effect for a given fiscal year to the grant expenditures during that fiscal year. For example, the indirect cost rates approved for the 2003-2004 fiscal year apply to all disbursements made within that fiscal year that are eligible for earning indirect costs, including any disbursements made on grant balances that are brought forward.

APPLICATION OF RATE

Once the proposal has been approved by the Idaho Department of Education, the district may elect to:

1. Apply the approved and applicable rate to all eligible federal projects;
2. Apply the approved and applicable rate only to specific eligible projects;
3. Not apply the rate to any grants;

The rate may be applied at the maximum rate or less than the maximum rate. If the rate applied is less than the maximum rate, then it is not necessary that the reduced rate be applied uniformly to all grants.

SUBMITTING THE INDIRECT COST PROPOSAL

The completed Indirect Cost Worksheet should be submitted to Public School Finance no later than February 15th. The completed worksheet should be returned to:

Idaho Department of Education
Public School Finance
PO Box 83720
Boise, Idaho 83720-0027

FAX: (208) 334-3484

Using the Indirect Cost Worksheet, the Department of Education will calculate a discounted restricted indirect cost rate sent the rate to the LEA.

USE OF RATES

Once the applicable rate has been determined, the amount available to earn indirect cost dollars can be computed by using the following formula:

$$I = S / R$$

I = Amount available to be assessed using the indirect cost rate

R = Applicable indirect cost rate (as a decimal) + 1

S = Net available for indirect and direct costs

The amount available to earn indirect cost is determined for an entitlement type grant or project, such as Title 1, by subtracting excluded costs (items of equipment, subcontracts, transfers, debt service costs, and flow-through funds). The remaining amount is the net available for both indirect and direct costs. The net amount available is divided by the combined amount of the indirect cost rate (in decimal format) plus 1.

For example, the indirect cost rate is .0321 (3.21%), the total entitlement for Title 1 is \$500,000, and the grant included \$1,400 for capital outlay:

Fixed Grant Amount: \$500,000

Less: Capital Outlay 1,400

Net Available for Indirect and Direct Cost 498,600

Amount available to be assessed an indirect cost rate:

$$\$498,600 / 1.0321 = \$483,093$$

Maximum Indirect Cost dollar amount:

$$\$483,093 \times .0321 = \$ 15,507$$

Indirect costs may be recovered only to the extent that allowable direct costs were incurred. The indirect cost rate is applied to the amount expended, not the total grant award, to determine the indirect cost dollars to be recovered.

SAMPLE INDIRECT COST AND INDIRECT COST CALCULATION WORKSHEETS

The Indirect Cost Worksheet, sent to districts around the end of January, shows the total expended for District Administration (Function/Program 632, Funds 100-600) during the prior fiscal year. Districts identify any unallowed costs coded to District Administration, record those costs on the Indirect Cost Worksheet, and return the worksheet to the Department of Education by February 15th.

The Indirect Cost Calculation Worksheet allocates the prior year expenditures into columns for indirect costs, excluded costs, and direct costs using the Annual Financial Report and the Indirect Cost Worksheet. The indirect cost rate is then calculated by dividing indirect costs by direct costs. The resulting percentage is then discounted by 5% to arrive at the Discounted Indirect Cost Rate that may be used by the districts during the upcoming fiscal year.

See the following pages for an example of the Indirect Cost Worksheet and the Indirect Cost Calculation Worksheet.