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Indirect Cost Plan

Information, Guidance, and Application of Indirect Rates

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# Authority

The Office of Management and Budget (OMB) Circular A-87 provides that federally assisted programs shall bear, in addition to direct costs, their fair share of indirect costs, except where authorizing legislation explicitly restricts reimbursement of such costs. Circular A-87 also establishes uniform principles for determining and distributing costs to federal grants and contracts. OMB Circular A-87 can be viewed and/or downloaded from the web at <http://www.whitehouse.gov/omb/circulars_a087_2004>. It is essential that Circular A-87 be read and understood in addition to these guidelines.

Local education agencies (LEAs) and Education Service Districts (ESDs) are required to have an approved indirect cost allocation plan and indirect cost rate in effect in order to recover any indirect costs related to federal grants and contracts. If a LEA or ESD does not wish to recover indirect costs for federal grants and contracts, it is not required to do so.

# Indirect Cost Calculation

An indirect cost rate is a device for determining, in a reasonable manner, what portion of allowable general administrative expenses each federal grant should bear.

Applications for grants and contracts usually involve a request for reimbursement of both direct and indirect costs. Indirect costs are those costs which are not readily identifiable with the activities of the grant or contract but are nevertheless incurred for the joint benefit of those activities and other activities and programs of the organization. Accounting, auditing, payroll, personnel, budgeting, and purchasing services are examples of services which costs may be attributed by means of an indirect cost allocation plan. In theory, all such costs can be charged directly. However, practical limitations and consideration of efficiency in accounting usually preclude such an approach. Conversely, direct costs are costs that provide measurable, direct benefits to a particular program.

Generally, an indirect cost rate is the ratio of total indirect costs to total direct costs, based on the actual expenditures of the LEA or ESD recorded and reported in accordance with the Oregon Program Budgeting and Accounting Manual (PBAM).

# Classification of Costs

### Direct Costs

Direct costs are those that can be identified specifically with a particular cost objective. These costs may be charged directly to grants, contracts, or to other programs against which costs are finally assigned. Typical direct costs chargeable to a grant include, but are not limited to:

* Compensation of employees for the time identified specifically to the performance of those programs;
* Cost of materials acquired, consumed, or expended specifically for the purpose of those programs;
* Travel expenses incurred specifically to carry out the program; etc.

### Indirect Costs

Indirect costs are those not readily identifiable with the activities of the grant but incurred for the joint benefit of those activities and other activities of the organization. In accordance with OMB Circular A-87, indirect costs are:

* Incurred for a common or joint purpose benefiting more than one cost objective; and
* Not readily assignable to the cost objectives specifically benefited, without effort disproportionate to the results achieved.

A cost may not be allocated to a federal program as an indirect cost if any other cost incurred for the same purpose, in like circumstances, has been assigned to a federal program as a direct cost. Typical examples of indirect costs may include: procurement, payroll, personnel functions, maintenance and operations of space, data processing, accounting, auditing, budgeting, communications (telephone, postage), etc.

### Unallowable Costs

OMB Circular A-87 classifies certain items of cost as unallowable. Unallowable costs cannot be charged to federal awards. For rate computation purposes, unallowable costs should be included in the direct cost base if such costs benefit from allowable indirect activities.

### Excluded Costs

Certain items of costs are classified as extraordinary or distorting expenditures and are excluded from the computation of the indirect cost rate. Examples include capital outlay/non-capitalized equipment, and debt services.

# Types of Rates, Exclusions and Limitations

### Restricted Indirect Cost Rates

* Restricted indirect cost rates shall be used for programs which require expenditures which supplement but do not supplant state or local efforts.
* Indirect cost rates shall include only those indirect costs associated with support services such as; director of business, fiscal, internal, staff, and data processing; and those other costs required by rule to be treated exclusively as indirect costs such as termination benefits.

### Exclusions

* All transactions in the Debt Service, Working Cash, Capital Projects, and Fire Prevention & Safety Funds are excluded.
* Any capital outlay, non-capitalized equipment, and food services food supplies reported in any fund are excluded.
* Any debt services and payments to other LEA charges reported in any fund are excluded.

### Limitations

* Federal laws limit the amount of indirect costs which may be allowed. The maximum indirect cost allowable by law for a particular federally funded program may be less than the amount allowed under OMB Circular A-87.
* Recovery of indirect costs is subject to availability of funds. If the total of direct and indirect costs exceeds funds available, the LEA will not be able to recover the total cost of the program. Indirect costs may be recovered only to the extent that direct costs are incurred. The indirect cost rate is applied to the amount expended, not the total grant award, to determine the amount of indirect costs. The following illustrates the calculations of indirect and direct costs:
1. Grant Amount $120,000
2. divided by (1+.ICR) 1.034
3. Direct Costs $116,054
4. Maximum Indirect Costs
5. Equals $3,946 (Line A-C)
* If direct costs are determined but not claimed for the grant or contract, such amount may be used as “local effort” if local matching funds are required.
* The simultaneous use of direct costing and indirect cost rate allocation of the same type of cost is prohibited. LEAs may not use direct costing for some projects within a particular grant and the indirect cost allocation for other projects within the same grant. If the direct costing methodology is used within a specific grant, then that methodology must be used for all federal grants and contracts issued under that specific grant for the LEA. Direct costing is permissible providing supporting records and documentation are maintained by the grantee.

# Computation Method for Determining Indirect Rates

As defined in the ED General and Administrative Regulations (EDGAR) at 34 CFR 75.563 and 76.563, restricted rates apply to grants that are made under federal programs with supplement-not-supplant requirements. This means that the funds are for support in addition to state and local funding. Such amounts are intended to supplement, but in no way replace local funds. Most of the federal grants that the LEA obtains through ED are “of have supplement-not-supplant” requirements and a restricted indirect cost rate must be used on the programs. ODE utilizes two methodologies for calculating restricted indirect cost rates:

### Education Service Districts (ESD)

Oregon utilizes the Predetermined Indirect Cost Rate methodology for Educational Service Districts (ESDs). Like the LEAs, ESD will need to apply for an indirect rate on an annual basis. Indirect costs are reduced by 5% to account for reasonable fluctuations in costs from year to year. Additionally, the predetermined methodology has an indirect rate cap of 9%. This means that a ESDs indirect rate may not exceed 9%.

The formula for computing predetermined indirect cost rates is as follows:

Predetermined Indirect Cost Rate = Indirect Cost Pool \* 95%

 Direct Base Costs + Unallowed Costs

### Local Education Agencies (LEA)

Oregon utilizes the fixed with carry-forward adjustment method for School Districts in the state. The formula consists of base rates plus adjustments *(see section E below)* for carry forward and is computed as follow:

Fixed with Carry-forward = Indirect Cost Pool + Carry-Forward

 Direct Base Costs + Unallowed Costs

A. Excluded Cost pool: Federal regulation identifies these as sub-awards (to organizations other than member school districts), capital outlay, debt service, fines and penalties, contingencies, and elections (other than those required by federal statute). Excluded costs are removed from the computation totals. However, they are listed on the preliminary rate detail sheet sent to LEAs in April/May of each year.

Sub-awards – When a sub-grant or contract is issued to an organization not in the SU, the first $25,000 of expenditures each year are reported as direct costs. Expenditures in excess of $25,000 per sub-grant or contract and per-year are excluded. In other words, if sub-grant /contract extends over multiple years, any amount in excess of $25,000 each year will be included in the calculation.

Food Services – If a school district contracts out for food services, the expenditures under the contract are reported as just described under sub-awards. If the school district operates its own food services, then the costs of supplies and materials are reported as excluded costs. All other costs are reported as direct costs.

Capital Outlay – Payments of principal and interest on capital outlays are excluded. Capital outlay includes land, buildings, improvements to grounds and fixed equipment costing more than $25,000.

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| **Excluded Costs**  |
|  |  |  |  |
| **All expenditures in Funds:** | **That are categorized in Functions:** |
| 300 | Debt Service Funds | 5100 | Debt Service |
| 400 | Capital Projects Funds | 5200 | Transfers of Funds |
| 600 | Internal Service Funds | 5300 | Apportionment of Funds by ESD |
|  |  | 5400 | PERS UAL Payment |
|  |  | 6%%% | Contingencies |
|  |  |  |  |
|  | **And/or objects** |
| **In addition, expenditures in Funds:** | 450 | Food Services |
| 100 | General Fund | 610 | Redemption of Principal |
| 200 | Special Revenue Funds | 620 | Interest |
| 500 | Enterprise Funds | 680 | PERS UAL Payment |
| 700 | Trust and Agency Funds | 690 | Grant Indirect Charges |
|  |  | 700 | Transfers |
|  |  | 800 | Other Uses of Funds |

B. Indirect Cost pool: This pool consists of all costs (less any capital outlay/non-capitalized equipment, or other costs charged as direct costs of the particular function) charged to the Educational, Operations & Maintenance (less capital outlay/non-capitalized equipment) charged to the Operation and Maintenance of Plant Services function (2540), Transportation, or Municipal Retirement/Social Security Funds for Fiscal Support Services (2520), Internal Support Services (2570), Staff Support Services (2640), and Data Processing Services (2660). Direction of Business Support Services (2510) charged to the Educational fund are included in this pool, while those expenses charged to the Operations & Maintenance Fund are included in the base direct cost pool.

C. Direct Base Cost pool: This pool consists of all costs (less any capital outlay/non-capitalized equipment, plus other costs charged as direct costs within the functions otherwise comprising the base indirect cost pool) charged to the Educational, Operations & Maintenance, Transportation, Municipal Retirement/Social Security or Tort Immunity Funds for Instructional Services (1000 series), Pupil Support Services (2100 series), Instructional Staff Support Services (2200 series), General Administration Support Services (2300 series), School Administration Support Services (2400 series), Direction of Business Support Services (2510 charged to the Operations and Maintenance fund), Pupil Transportation Services (2550), Food Services (2560, less cost of food), Direction of Central Support Services (2610), Planning, and Evaluation Services (2620), Information Services (2630), Other Support Services (2900), and all Community Services (3000 series).

Termination Benefits - Definition of ‘Severance Pay’ (with regard to termination benefits): In practical terms, this refers to a one - time payment to a retired or terminated employee only for accumulated sick and/or vacation days. Compensation for such unused sick and/or vacation days through an increase in annual salary– whether for one, two, three or more years is not considered a “termination benefit.”

######  Severance – Normal Turnover

 Payments to employees that are tied to normal turnover as required pursuant to established personnel policies. Normal severance costs are relatively insignificant costs resulting from normal operations, not costs related to program cutbacks or elimination, reductions in work force, buy outs, etc. Normal severance costs are to be included in an LEA’s indirect costs.

######  Severance – Abnormal Turnover

 Abnormal or mass severance includes expenses associated with events that are offered to employees as an incentive to leave employment such as:

* Buy-outs
* Lump sum payments linked to years of service
* Increased pension benefits

Abnormal termination benefits must be considered in advance on a case by case basis by the ED. Abnormal severance costs are not allowable unless there is a demonstrated allocable and reasonable benefit to federal programs.

The cost data for the calculations are taken from audited Annual Financial Reports for the fiscal year (2) years prior to the fiscal year to which the resulting fixed indirect cost rate will be applied. That is, for Fiscal Year FY 2015 federal programs the rates are determined from the costs reported in FY 2013 Annual Financial Reports. In order to more accurately estimate the costs for FY 2015, additional adjustments for carry forward are applied.

D. Unallowed Cost Pool:Unallowable costs are those costs that are unacceptable as applied to federal grants and contracts whether applied directly to a grant or indirectly through the indirect cost rate. Using OMB A-87 Attachment A3.B and the 2008 PBAM as a guide, the following funds, objects and functions are unallowed costs with certain exceptions noted later. Unallowable costs include:

* Bad Debts
* Contributions and donations
* Entertainment
* The office of the chief executive of the LEA
* Interest and other financial costs
* Lobbying

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| **Expenditures in Funds:** | **Categorized in Functions:** |
| 100 | General Fund | 2310 | Board of Education Services |
| 200 | Special Revenue Funds | 2320 | Executive Administration Services |
| 500 | Enterprise Funds | 4000 | Facilities Acquisition & Construction |
| 700 | Trust and Agency Funds | 5100 | Debt Service |
|  |  | 6%%% | Contingencies |
| **and/or Objects** | 7%%% | Unappropriated Ending Fund Balances |
| 430 | Library Books |
| 500 | Capital Outlay |
| 650 | Insurance and Judgments |
| 670 | Taxes and Licenses |

* Under recovery of cost under grant agreements

E. Carry-Forward Calculation:The indirect cost rates are computed and fixed for a specified future period based on an estimate of that period’s level of operation. However, when the actual costs of that period become known, the difference between the estimated cost and the actual cost is carried forward as an adjustment to a subsequent period for which a rate is established. The adjustment cannot be made in the fiscal period immediately following because the fixed rate for that period will already have been determined. The adjustment will be carried forward to the second fiscal period following the period being adjusted.

Indirect cost rates are computed based on information taken from the annual expenditure data included in the Database for Education submittals. The PBAM classifications allow expenditures to be classified as indirect, direct (unallowed) or excluded, with the exceptions noted below. All reported amounts in the categories listed below have been considered direct in the rate computation, but could be considered indirect cost depending on the type of expenditure. LEAs and ESDs will need to use the website for the Indirect Rate Certification System for submitting information to ODE.

F. Adjustments:For LEAs, the process involves make adjustments. There are two categories of adjustments – mandatory and optional. The use of optional adjustments should be weighed against the cost benefit of time spent preparing them. Annually the adjustments that are categorized as mandatory and/or optional may change. Therefore, it is the responsibility of the institutions (LEAs) in Oregon to verify the adjustments necessary for the given year with ODE. Described below are the known areas in which adjustments could be made to the indirect cost plan. Justification shall be provided on the ICR Certification website regarding what the cost is and why the LEA is including the adjustment. In the event an additional adjustment is made by the LEA, ODE will review the justification and either deny or approve the adjustment based on the LEA Indirect Cost Plan and other federal resources pertaining to indirect rate calculations.

General Administration - The principles of OMB Circular A-87 exclude the Superintendent, Deputy Superintendent, Head of Sections (includes support for these positions) and Board of Education costs from indirect consideration. However, a revised interpretation was received that allows some leniency for small school district administrators who, on a day to day basis, perform such functions identified in the plan as indirect, provided the time and effort documented for these activities are sufficient to pass an audit. Superintendents of small school districts who wish to recover indirect cost on the business administration part of their job function will have to categorize part of their salary under Function 2510 to be eligible for indirect cost consideration. However, since it takes two years for changes in accounting to show up in indirect calculations automatically, documentation is necessary for the amounts to be manually shifted to Function 2510.

Sub-Award/Contract Amounts in Excess of $25,000 - only the first $25,000 of any given contract is allowable as a direct or indirect cost per fiscal year. Any amounts above $25,000 on a per-contract basis must be excluded from the indirect cost rate calculations. When a sub-grant or contract is issued to an organization not in the SU, the first $25,000 of expenditures each year is reported as direct costs. Expenditures in excess of $25,000 per sub-grant/contract and per-year are excluded. In other words, if sub-grant or contract crosses multiple years, any amount in excess of $25,000 each year will be included in the calculation.

Terminal Leave – any expenditures associated with the departure of an employee such as the payoff of sick or vacation leave - is considered an indirect cost with the exception of terminal leave for the Superintendent, Deputy Superintendent and heads of sections and support staff that report to these staff. In these cases, it should be placed in the base.

Insurance and Judgments -District liability insurance, district property insurance and fidelity bond premiums and worker’s compensation may be classified as indirect cost. Adjustments may also be made for unemployment compensation for employees or former employees whose costs were associated with the functions identified as indirect in this plan. You may not include judgments against the district as indirect cost pools.

Food Service - The cost of food is excluded from the indirect cost pool. The cost of food is included by some LEAs in Function 3100, Object 410 – along with other consumables in the food service program. The portion of these expenditures that are not food can be reclassified as a direct expense if a LEA submits the breakout between food and non-food for this expenditure Function/Object code. Starting with the 2005-06 fiscal year, the cost of food will have its own Object code #450 and thus starting with rates for 2007-08 no adjustments to the indirect cost rate calculations will be needed, unless the LEA does not use the 450 object code for food services.



**Negative Indirect Cost Rates -** will not be issued. If the ODE computation for the restricted or unrestricted rate results in a negative value, a zero indirect cost rate will be assigned to the LEA for the applicable fiscal year.

# Application of Indirect Cost Rates

Once you have an approved indirect cost rate and have begun the fiscal year, you can periodically draw down indirect against your direct grant expenditures. These are simple to compute. First you identify those direct expenditures under a grant for which you can recover indirect costs – referred to as your “base costs.” These are the same expenditures that are included in the direct base cost pool in your calculation.

For LEA's only, all direct costs except the following:

* The portion of sub-grants that go to organizations other than member schools that exceed $25,000 each fiscal year– only the first $25,000 is included in the base of application for each fiscal year of the award;
* The cost of equipment purchases or alterations and renovations to facilities.

Once you have established your base costs for a specific grant, simply multiply that by your indirect cost rate which yields the amount of indirect costs that you can recover under that grant. For example, if you have expended $25,000 under Title I and you have an restricted indirect cost rate of 2%, then, in addition to drawing down the $25,000 of direct costs under the grant, you can also draw down $500 ($25,000 X .02 = $500) of indirect costs.

#### Limitations on recovering indirect costs

* While charging indirect is a simple calculation, there are some limitations that apply.
* Indirect costs are recovered only after expenditures have been made under a grant. The indirect cost rate is applied to the direct cost amount expended, not to the grant award.
* Recovering indirect costs does not increase the amount of the grant. The amount of a grant that goes toward indirect costs reduces the amount available for direct grant expenditures.
* Indirect costs are administrative costs to a grant. Indirect costs cannot be charged if the grant prohibits administrative expenditures. If the grant has an administrative ceiling, your combined direct administrative expenditures and your indirect expenditures cannot exceed the amount allowed for administration.
* The indirect cost rate is the maximum that can be charged to any one grant. If you cannot charge an indirect rate under one grant, you cannot make up for it with a higher rate under another grant. You can always apply a lower rate to a specific grant but you can never apply a higher rate.
* An indirect cost under one grant cannot be a direct cost under another grant. If indirect funds are utilized to pay for your central office functions, then central office functions cannot be direct costs under another grant.

# Certification by Agency Official

The federal government requires this certification before rates can be finalized for any local education agency. LEAs and ESDs will certify electronically through the Indirect Cost Rate System (ICRS) on the district webpage. For LEAs, this is to occur after they submit the mandatory adjustments and complete the sub award list. The authorized agency, ODE, then reviews and finalizes the annual rate. An electronic email sends back to the LEA or ESD business manager, through the generic business manager email system, with a full listing of approved and/or denied adjustments and includes finalized approved rate by the ODE.

The restricted rate applies to grants that are made under federal programs with the “supplement-not-supplant" provision. Although the indirect cost rates are calculated for use with federal programs, the state fiscal year should be used. ESDs use the 2014-15 rates through June, 2015, and then use the 2015-16 rates beginning July, 2015. The rate should be used in the year the funds are expended, which is not necessarily the same as the year the funds are appropriated, received, or encumbered. If more than one year is involved in a project, the indirect cost rate used to recover indirect costs should change as the fiscal year changes.

# Attachment A

## Indirect Cost Classification Matrix