

INDIRECT COST GUIDELINES

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.

The majority of funding provided to Local Education Agencies (LEAs) is from the United States Department of Education (USDE) passed through the State Education Agency (SEA). Although LEAs may also receive awards directly from a federal agency, USDE delegates authority for LEAs' indirect cost rate determination to the SEA. As such, the USDE has approved a delegation agreement with the Kentucky Department of Education (KDE) that authorizes KDE, as the cognizant agency, to establish indirect cost rates for Kentucky's LEAs.

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 LEA's actual expenditures, less excluded costs such as capital outlay or major sub-awards.

The district's Audited Annual Financial Report (AFR) is used to calculate indirect cost rates. Therefore, it is essential that LEAs classify expenditures uniformly and consistently and in accordance with the Chart of Accounts maintained on the KDE website. Districts are responsible for understanding the requirements of OMB Circular A-87 and must verify the accuracy of the data used in the indirect cost rate calculation by completing the Indirect Cost Rate Adjustment form accessible via the SEEK system. Necessary adjustments may be made

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by completing the form or a district may indicate that no adjustments are needed. Instructions for completing the form can be found on the KDE website at the following link: [Indirect Costs](#)

Expenditures for the second preceding fiscal year are used when calculating the indirect cost rates for a given fiscal year. For example, expenditures for 2014-15 are used to calculate the indirect cost rates for the 2016-17 fiscal year.

The Non-Restricted and Restricted Indirect Cost Rate Calculations for each district can be found on the KDE website at the following link: [IndirectCosts](#)

Kentucky utilizes the Predetermined Indirect Cost Rate methodology whereby indirect costs are reduced by 10% to account for reasonable fluctuations in costs from year to year. KDE is currently employing the three year delegation agreement which was effective December 26, 2014. Therefore, the current methodology is approved for use through the 2016-17 rate determination. Upon resubmission of the methodology to USDE in December, 2017, revisions to the indirect cost rate calculation may be necessary.

Generally, records and documentation supporting the indirect cost allocation plan must be retained for a period of three years after the last day of the fiscal year to which the proposal applies or until audited, whichever occurs sooner. If audit exceptions have been noted, records must be retained until those exceptions have been resolved.

APPROVAL OF RATES

Each local board of education is encouraged to approve the indirect cost rates however, it is not a requirement. The indirect cost rates must be approved by the Kentucky Board of Education prior to July 1 in order for districts to claim indirect costs for the period, however approval of the rates does not commit the local board to make indirect cost claims against grants.

APPLICATION OF RATES

Once the rates have been calculated and approved by the Kentucky Board of Education (and if desired, the local board) the LEA may elect to:

1. Apply the applicable rate, or a lesser rate, to all grants,
2. Apply the applicable rate, or a lesser rate, to only specific eligible grants, or
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, the LEA may not average the indirect cost charges to projects; that is, if the approved rate was six percent, charge one project at three percent and another project at nine percent for an average of six percent.

The rate is applied to the actual expenditures incurred in the period equal to: total direct costs of the project less excluded costs which may include equipment purchases, alterations and

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renovations, on-behalf payments, and pass-through funds. In the food service program, the rate is applied to actual salaries and benefits (not including on-behalf payments) for the period.

The restricted rate applies to grants that are made under federal programs with the “supplement but not supplant” restriction. This means that funds are to be used for support in addition to state and local funding. Such funding is intended to supplement, but in no way replace, state and local funds. The non-restricted rate applies to grants that are not subject to the “supplement but not supplant” restriction, such as food service. The difference in the two rates is that Plant Operations and Maintenance (function 2600) is included in indirect costs for the calculation of the non-restricted rate but is excluded from indirect costs for calculation of the restricted rate. See Attachments A and B for illustrations of the indirect cost rate calculations.

Approved indirect cost rates are necessary in order to compute the indirect cost amounts that may be recovered from a federal program. Indirect cost charges may be made only to a project's direct actual expenditures as they occur by applying the approved indirect cost rate for that particular fiscal year. A project's encumbrances at the end of a fiscal year are not yet eligible for indirect cost charges and also are not subject to that fiscal year's indirect cost rate, but are eligible for indirect cost charges in the fiscal year in which they are paid by applying that "payment" year's indirect cost rate.

Since the indirect cost rates are calculated based on fiscal year data, the rates should be applied on the same basis which is July 1 through June 30. The rate used is determined by the year in which 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. For example:

<p>\$50,000 grant award received May 2015 \$10,000 of allowable direct costs is expended in December 2015 \$30,000 of allowable direct costs is expended in October 2016</p> <p>Apply the 2015-16 rate to \$10,000 Apply the 2016-17 rate to \$30,000</p>

There are certain limitations on recovery of indirect costs:

1. Federal law may limit the amount of indirect costs which may be recovered. For example, the maximum indirect cost allowable by law for a particular program may be less than the amount allowable under OMB Circular A-87. Some grants may prohibit any recovery of indirect costs.
2. Recovery of indirect costs is subject to availability of funds. If a combination of direct and indirect costs exceeds funds available, then the LEA will not be able to recover the total cost of the project or programs.
3. Indirect costs may be recovered only to the extent that direct costs were incurred.

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The indirect cost rate is applied to **actual** direct expenditures, not to the total grant award, in order to determine the amount for indirect costs.

Expenditures that are identified as indirect costs cannot also be included as direct costs. Examples include postage, rent, local telephone service, utilities, or audit costs. If these costs are charged directly to a federal program, they cannot be included in the entity's indirect cost pool for rate setting purposes. Similar types of expenditures must be consistently accorded the same accounting classification.

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. For example, if expenditures for custodial services are treated as a direct cost for food service, then it must be treated as direct cost for all other federal programs and cannot be included in the indirect cost pool.

The indirect cost rate may not be applied to excluded costs which include expenditures for capital outlay, capitalized equipment, and on-behalf payments.

Indirect costs may not be recovered on direct costs attributable to equipment purchases that equal or exceed the entity's capitalization level (the dollar threshold on which it is determined that equipment will be inventoried) for financial statement purposes. If the total cost of the equipment does not meet the entity's capitalization level, the total cost of the equipment is considered a supply item and may be included in the direct cost base (denominator) upon which indirect costs are calculated. In addition, indirect costs may not be recovered on other capital assets (buildings, land, and improvements to buildings and land that materially increase their value or useful life).

Any unearned, i.e., excess indirect costs charged, must be rebated to the Federal funding source.

Earned indirect cost charges are recognized by making an adjusting journal entry periodically as follows:

Debit 0002113-0913 or 0005113-0913	Indirect Cost Transfers Out (<i>special revenue or food service fund</i>)
Debit 10-6101	Cash (<i>general fund</i>)
Credit 110-5220	Indirect Cost Transfers In (<i>general fund</i>)
Credit 20-6101 or 51-6101	Cash (<i>special revenue or food service fund</i>)

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DEFINITIONS

Direct Costs – Costs that are 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.

Excluded Costs – Costs identified in OMB Circular A-87 as those items which must be excluded from the indirect cost rate determination because they require minimal administrative support. Excluded costs include but are not limited to: pass-through funds, sub-awards exceeding \$25,000, on-behalf payments, capital outlay, debt service, certain transfers, and food purchases. The same costs are excluded when applying the indirect cost rate to actual expenditures.

Indirect Costs – 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.

Indirect Cost Rate – Device for determining, in a reasonable manner, the proportion of indirect costs each program should bear. The indirect costs are included in the numerator (the indirect cost pool) and the direct costs are included in the denominator (along with unallowed costs under the Kentucky methodology). The result is expressed as a percentage (rate) of the indirect costs to direct costs (and unallowed costs).

Local Education Agency (LEA) – A public board of education or other public authority legally constituted within a state for either administrative control or direction, of public elementary or secondary schools in a city, county, township, school district, or other political subdivision of a state.

State Education Agency (SEA) – The state board of education or other agency or office primarily responsible for the supervision of public elementary and secondary schools in a state.

Sub-award – An award made by a recipient to an eligible subrecipient. The term includes financial assistance provided by any legal agreement (including contracts) but does not include the procurement of goods and services.

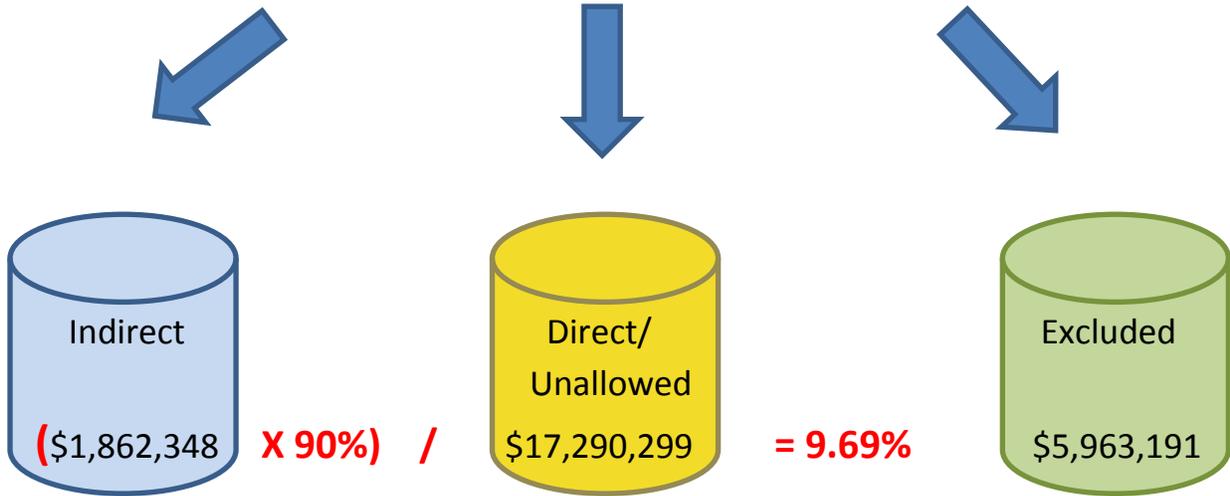
Unallowed Costs – Costs identified in OMB Circular A-87 as those items for which federal funds shall not be expended. These are costs directly attributable to governance. For rate computation purposes, disallowed costs are combined with direct costs to arrive at the denominator. Unallowed costs include but are not limited to: bad debts, fines and penalties, and contingencies.

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ATTACHMENT A Indirect Cost Calculation Non Restricted Rate

Total Expenditures of \$25,115,838

(Funds 1, 2 and 51 Functions 1XXX-5XXX, Objects 01XX-0998, EXCEPT Fund 1, Function 3100)



(Funds 1 and 2, Functions 2500 and 2600, all objects EXCEPT 0280 and 0700 and project 16MX; plus Fund 1, Function 2300, objects 0342 and 0344)

(Everything that is not identified as Indirect or Excluded)

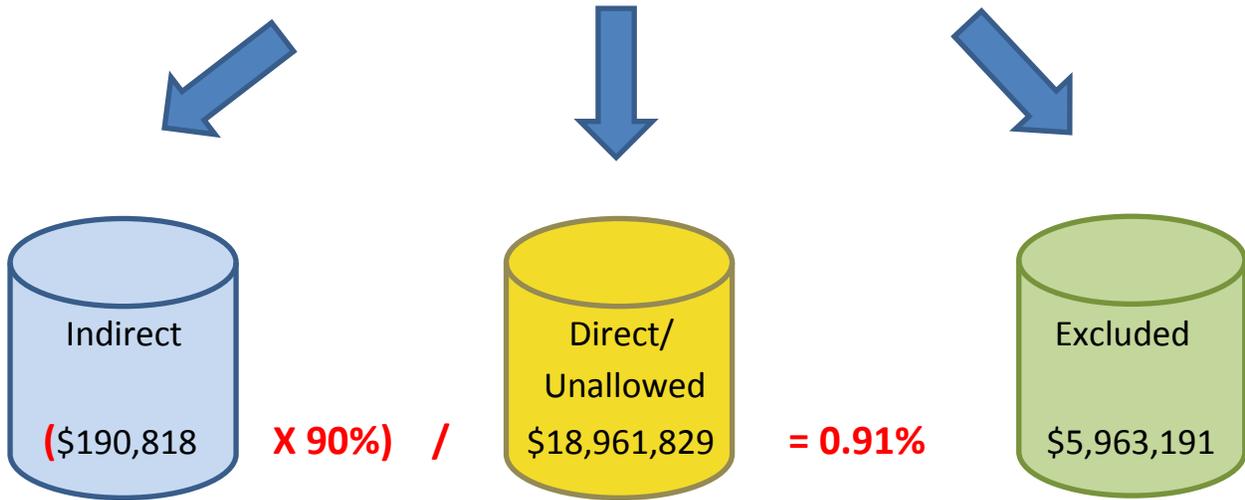
(Funds 1, 2 and 51, Function 5XXX; Funds 1 and 2, Function 4XXX; Funds 1, 2 and 51, object 0700; Funds 1 and 51, object 0280; project 16MX; Fund 51, objects 4500 and 4950)

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ATTACHMENT B Indirect Cost Calculation Restricted Rate

Total Expenditures of \$25,115,838

(Funds 1 and 2, Functions 1XXX-5XXX, Objects 01XX-0998, EXCEPT Fund 1, Function 3100)



(Funds 1 and 2, Function 2500, all objects EXCEPT 0280 and 0700 and project 16MX; plus Fund 1, Function 2300, objects 0342 and 0344)

(Everything that is not identified as Indirect or Excluded)

(Funds 1, 2 and 51, Function 5XXX; Funds 1 and 2, Function 4XXX; Funds 1, 2 and 51, object 0700; Funds 1 and 51, object 0280; project 16MX; Fund 51, objects 4500 and 4950)

The difference between Non Restricted and Restricted is that Plant Operations and Maintenance (\$1,671,530) moves from "Indirect" to "Direct/Unallowed"