

**Instructions for
Making Application
for An Indirect Cost Rate
for
Local Education Agencies**

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**Finance Division
(802) 479-8545**

Instructions for Making Application for An Indirect Cost Rate for LEAs

1. What is an Indirect Cost Rate?

When you receive a federal grant, it includes a set of approved activities that carry out the purpose of the grant. The costs of these activities are referred to as “direct costs.” Direct costs are easily identifiable and assigned to a grant. When a person carries out the work of the grant, his/her time spent doing so is recorded and a proportionate part of his/her salary and benefits are posted as direct costs to the grant. The same is true of costs of the other activities included in your grant proposal such as professional development, instructional supplies, etc.. They are documented and posted as direct costs to the grant.

The federal government realizes, however, that the true cost of carrying out the grant includes both these direct costs and a portion of the costs of central office functions that support the administration of the grant. These central office costs such as accounting, payroll, and human resources are referred to as “indirect costs.” OMB Circular A-87 – the Cost Principles for State and Local Governments – defines “indirect costs” in this way:

Indirect costs are those: (a) incurred for a common or joint purpose benefiting more than one cost objective (function, grant... for which cost data is necessary), and (b) not readily assignable to cost objectives specifically benefited, without effort disproportionate to the results achieved.

(OMB Circular A-87, PART A, F.1)

Because it is inefficient or impossible to separate out such costs, federal regulations provide for their recovery through allocating them to the cost objectives that they support. This cost allocation process assumes that these support costs are proportionate to the amount of funding being administered. Regulations prescribe a way to calculate what is spent on general management (indirect costs) for every dollar that is spent on operations (direct costs). The percentage that indirect costs are of direct costs is the indirect cost rate. For example, if the total cost of operations of schools in SU region A is \$20 million dollars and the total central office costs for accounting, payroll, etc. are \$400,000, then SU region A’s indirect costs are 2% of its operating or direct costs. In this instance, it would have an indirect cost rate of 2%.

In order to recover the indirect costs of a grant, a grant recipient is allowed to charge indirect costs on the direct cost expenditures of the grant at its established indirect cost rate. Returning to our example above, SU region A has an indirect cost rate of 2% and is allowed to charge this additional percentage for every dollar it expends on the direct costs of a grant. If the SU expends \$300,000 under Title I on direct costs, it can pull down that amount to pay its direct costs under the grant and an additional \$6,000 ($\$300,000 \times .02 = \$6,000$) to cover its indirect costs.

2. Who applies for an Indirect Cost Rate?

Federal regulations stipulate that Local Education Agencies (LEAs) that are the recipients of federal funds can apply to their State Education Agency (SEA) for an indirect cost rate, whether those funds come directly from the federal government or are sub-granted to it by the State Education Agency. The Vermont Department of Education is the SEA for the state of Vermont.

In order to set indirect cost rates for LEA's, the Vermont Department of Education has had approved by the US Department of Education a process for setting such rates. The design of that process was guided by the goal of keeping the application, approval and implementation steps as simple as possible.

For that reason, the rate for which LEAs can apply has the following characteristics:

- The rate set is a **single rate** – This means that the same rate is used for all your federal grants.
- The rate is a **restricted rate**. A restricted rate must be used for all grants that have a “supplement and not supplant provision” – a provision that accompanies almost all the federal funds that the department grants to sub-recipients. In very rare instances, when an LEA receives a sizable grant, in excess of \$100,000, from the department or directly from the US DOE that does not have this provision, provision is made for applying for an unrestricted rate, for the grant/s.
- The rate is a **fixed rate with carry-forward**. The federal government takes steps to insure that more funds are not utilized for indirect costs than regulations allow. A rate is set for a fiscal year using fiscal data from two years prior. However, when that fiscal year becomes the base in two years, adjustments are made to reflect the difference between the calculated rate and the actual rate.

In Vermont, the LEA that applies for such a rate is the supervisory union/district. State regulations designate the supervisory union or supervisory district to be the LEA for most federal grants. Hence, the Vermont Department of Education, as the SEA, sets indirect cost rates for supervisory unions and supervisory districts.

When a supervisory union/district receives a state-administered federal grant that is formula driven, its grant is calculated using data of its member school districts. Similarly, when a supervisory union applies for an indirect cost rate for its region, the financial data it reports to run the calculation is not just the SU's expenditures but the indirect and direct expenditures of it and all the member schools. Hence the supervisory union/district applies for and is assigned an indirect cost rate as a supervisory region. If a school district that is a member of a supervisory union receives a federal grant, it uses the indirect cost rate set for its supervisory region.

The application for an indirect cost rate, therefore, requires that the supervisory union/district submit fiscal data on its region. This requires some time and effort and, because applying for this rate is voluntary, it should weigh whether it is worthwhile to do so. In so doing, it should keep these facts in mind:

- By defining the supervisory union as its region, the resulting indirect cost rate is usually in the 2-3% range. Hence, for smaller districts, the amount of indirect costs that can be assessed can be quite small.
- The ability to pull down indirect costs does not increase the amount of the grant. Your total of direct and indirect costs cannot exceed the amount of the grant. Collecting indirect costs reduces the amount available for direct expenditures.
- Indirect expenditures are reported under administration and they can only be charged under grants that allow for a portion going toward administration. Additionally, they do not increase the amount that can be utilized for administration and total administration expenditures cannot exceed the ceiling set in the grant.

So why would you want to go to the trouble of applying for an indirect cost rate and of charging indirect costs to a grant? Quite simply, it is the only reasonable way to access federal grant funds to pay for the support the grant requires from the central office. If federal participation in these costs is important and necessary in your region, then you should make application for an indirect cost rate.

3. How to apply for an Indirect Cost Rate

To obtain an indirect cost rate, the supervisory union/district (hereinafter referred to as the SU) as the LEA applies to the Vermont Department of Education for a rate and through a process approved by the US DOE. These are embedded in the attached worksheets. The SU applies for its indirect cost rate by filling out the appropriate worksheet/s and submitting it to the Vermont Department of Education. There is a *Worksheet for Computing a Restricted Indirect Cost Rate* and a *Worksheet for Computing an Unrestricted Indirect Cost Rate*. Which do you use?

In most cases you will fill out only the *Worksheet for Computing a Restricted Indirect Cost Rate*. You must use a restricted indirect cost rate for every grant that includes a “supplement and not supplant provision.” Since over 95% of the funds awarded by the department to LEAs includes such a provision, most if not all the grants you are awarded are eligible for only a restricted indirect cost rate. This rate can also be used for grants that don’t include this provision.

An unrestricted indirect cost rate can be used for grants that do not include the “supplement and not supplant” provision. This rate is always higher than a restricted rate because it allows more expenditures – specifically those of the superintendent’s office - to be included in the indirect costs. It will be worthwhile to apply for the unrestricted rate only if you receive a sizable grant from the department or directly from the federal government without the supplant provision. When this rate is approved, it can only be used for these specific grants.

Instructions for “Worksheet for Computing a Restricted Indirect Cost Rate”

Supervisory Union/District

Enter the name of your supervisory union or district. Remember, you are applying for your whole supervisory region and data reported includes the supervisory office and all member schools.

For Fiscal Year FY 200_

Your restricted indirect cost rate will be effective for one fiscal year. Make sure that you are using the spreadsheet issued for the fiscal year for which you are applying.

Fiscal Data Reported: 200_

You report the data for the fiscal year that is two years prior to the year of your indirect cost rate, e.g. an indirect cost rate for FY 2006 is based on the fiscal data for FY 2004. All expenditures, federal and non-federal, should be reported for that fiscal year. **All expenditures should appear only once in the spreadsheet** – either in the numerator, denominator, or excluded section. How expenditures are to be sorted among these categories is described in detail below and in federal regulations 34 CFR § 76.563-569.

Numerator – Indirect Costs

Begin the calculation for a restricted indirect cost rate by identifying your indirect costs in the numerator. Indirect costs include general management costs and fixed costs. Federal regulation defines these as:

§76.565 General Management Costs – Restricted Rate

(a)...General management costs means the costs of activities that are for the direction and control of the grantee's affairs that are organization-wide. An activity is not organization-wide if it is limited to one activity, one component of the grantee, one subject, one phase of operations, or other single responsibility.

*(b) General management costs include the costs of performing a service function, such as accounting, payroll preparation, or personnel management, that is normally at the grantee's level even if the function is physically located elsewhere for convenience or better management. The term also includes **occupancy and space maintenance costs as determined under §76.568.***

(c) The term does not include expenditures for –

- (1) Divisional administration that is limited to one component of the grantee;*
- (2) The governing body of the grantee;*
- (3) Compensation of the chief executive officer of the grantee*
- (4) Compensation of the chief executive officer of any component of the grantee; and*
- (5) Operation of the immediate offices of these officers.*

§76.566 Fixed Costs – Restricted Rate

Fixed costs means contributions of the grantee to fringe benefits and similar costs, but only those associated with salaries and wages that are charged as indirect costs, including –

- (a) Retirement, including State, county, or local retirement funds. Social Security, and pension payments;*
- (b) Unemployment compensation payments; and*
- (c) Property, employee, health, and liability insurance.*

§76.568 Occupancy and space maintenance costs – Restricted Rate

(a) As used in the calculation of a restricted indirect cost rate, occupancy and space maintenance costs means such costs as-

- (1) Building costs whether owned or rented;*
 - (2) Janitorial services and supplies*
 - (3) Building, grounds, and parking lot maintenance;*
 - (4) Guard services;*
 - (5) Light, heat, and power;*
 - (6) Depreciation, use allowances, and amortization; and*
 - (7) All other related space costs.*
- (b) Occupancy and space maintenance costs associated with organization-wide service functions (accounting, payroll, personnel) may be included if a space allocation or use study supports the allocation.*
- (c) Occupancy and space maintenance costs associated with functions that are not organization wide must be included with other (direct) expenditures.*

These indirect costs are entered in the Worksheet under the following functions:

- **Support Services Business** – The indirect costs for accounting and payroll reported in the numerator are those that normally would be reported under 2500 in the annual statistical report. Since this is a fiscal report for the whole supervisory region, these should include such costs for the central office and member school districts.

- **Personnel Support** – These costs are those associated with organization-wide human resources and personnel support. If such costs are included, identify the code under which they were reported.
- **Other Central Support** – These are other organization-wide, central support functions such as data, statistics, information services, and evaluation that were once reported under 2800 and are now included in 2900. Report only those 2900 costs that can be considered as general administration and support.
- **Fixed Costs** – If fixed costs – fringe benefits, insurance - for general management personnel were not included under 2500, identify them and the code under which they were reported.

Fixed costs also include **terminal leave costs** for the employees in the region since they are usually indirect costs. However, there is one exception; because this indirect cost rate is a restricted rate, the terminal leave costs associated with the superintendent's office is included in the direct cost base – the denominator. Note - these are considered direct costs for indirect cost rate calculation purposes only because terminal leave costs can never be charged as direct costs to any federal award. All other terminal leave costs should be reported as part of your fixed costs.

Finally, fixed costs also include **Post Retirement Health Benefits (PRHBs)** paid for employees in the region. While most PRHBs for teachers are paid by the state, the PRHBs for employees not covered by the state or the benefits in addition to those paid by the state paid by the SU or schools in the region are included here in your fixed costs. The one exception, again, are any PRHBs associated with the superintendent's office. These, like terminal leave costs, are included in costs of the superintendent's office and calculated in the direct cost base.

- **Occupancy and Space Costs** – Space costs for general administration might have been included under other codes but can be included **if you have on file a cost allocation plan that reasonably assigns these costs to the personnel included under indirect costs.** Space costs not allocated to general administration, e.g. the superintendent's office, are to be reported under direct costs.

Excluded Costs

After you have identified your indirect costs, identify all the costs that will be excluded from the calculation and enter them into the worksheet. These are identified so that they do not appear in the denominator as direct costs. 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).

- **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 in the first year are excluded. If the sub-grant or contract is for multiple years, from the second year onward, the entire amount is excluded.
- **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.

Denominator – Direct Costs

Finally, enter all expenditures not included under indirect or excluded costs in the appropriate line under direct costs. All expenditures not reported elsewhere in the worksheet should be identified and reported under “other expenditures.”

Calculated Indirect Cost Rate

Once you have entered all your expenditures in the appropriate place, your restricted indirect cost rate will calculate automatically. For the first two years that you draw down indirect costs, you will use this calculated indirect cost rate. In any year after that, an adjustment based on the difference between the fiscal data used to set the rate for the year being used as a base and the actual fiscal data of that year takes effect.

Adjusted Indirect Cost Rate

For the third year that your LEA is applying for its restricted indirect cost rate, you must fill in the data for the calculation of an adjusted indirect cost rate. The only data that you must supply is the indirect cost rate that you had approved for the year of base data. The rest of the computation will occur automatically.

Instructions for “Worksheet for Computing a Unrestricted Indirect Cost Rate”

As stated previously, in rare instances when your LEA receives a sizable grant from the department or directly from the US DOE that does not include a supplant prohibition, you may wish to also apply for an unrestricted indirect cost rate. To do so, you should fill out worksheet #2. The same definitions and reported expenditures are used in this worksheet as those for the restricted indirect cost rate with one change. In the unrestricted indirect cost rate, the expenditures reported under 2220 – *Office of the Superintendent* are moved from the direct cost base to the indirect cost base. Again, after you have used an approved unrestricted indirect cost rate for two years, you would enter the approved rate for the base fiscal year in the adjustment section of the worksheet and apply for the adjusted rate for the third year.

After you have completed the worksheet/s, and send them to:

Cassandra Ryan
Vermont Agency of Education
219 North Main Street, Suite 402
Barre, VT 05641

Your information will be reviewed and you should receive a reply from the department within one month. In most cases, the rate/s that you will be given is the rate/s calculated on your worksheet/s. However, the worksheet/s must be reviewed by the department for accuracy and consistency with the STAT reports from your SU region. You will be notified by the department of your approved indirect cost rate/s after this review. **Do not use an indirect cost rate before it has been approved and keep documentation of this approval as part of your financial record.**

It would be best if you filed for an indirect cost rate for a particular fiscal year prior to the beginning of that fiscal year. The spreadsheet for a fiscal year will always be sent out in the

January of the fiscal year prior to the fiscal year for which you are applying. Please submit your application before **June 1** if you wish to have a rate in place by the beginning of the fiscal year.

While having a rate set before the beginning of a fiscal year lets you budget more accurately, you can apply for an indirect cost rate at any point during the fiscal year. You cannot apply for a rate after you have closed your books for the fiscal year. The rate must have been applied before you submit your SDE 1.1. final report.

4. How to use the Indirect Cost Rate

Recovering indirect costs

Once you have an approved indirect cost rate and have begun the fiscal year, you can periodically draw down indirects 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 of application.” These are the same expenditures that are included in the direct cost base in your calculation. They are all direct costs except the following:

- the portion of sub-grants that go to organizations other than member schools that exceed \$25,000 – only the first \$25,000 if included in the base of application and only during the first year of the award
- the cost of equipment purchases or alterations and renovations to facilities.

Once you have established your base of application 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 \times .02 = \500) of indirect costs. If you do this periodically during the grant year, it would probably be best to do just before submitting your quarterly SDE 1.1. If you do so, when you report your expenditures on the SDE 1.1, these will include your direct costs under the grant plus your indirect costs for that quarter.

Limitations on recovering indirect costs

While charging indirects is a simple calculation, there are some limitations that apply.

- a) 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.
- b) 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.
- c) 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.
- d) 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.
- e) An indirect cost under one grant can not 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.

Accounting for Indirect Costs

When you receive payment for indirect costs, payment can be made to your central office and appear in the grant account as indirect payments. The expenditure of these funds require only that you follow your normal policies for payroll and expenditures.

Contact Information

For making application or for requesting information or assistance, contact:

Cassandra Ryan
Phone: (802) 479-8545

By mail at:
Federal Fiscal Services
Vermont Agency of Education
219 North Main Street, Suite 402
Barre, VT 05641