The simplified Indirect cost rate guide questions and answers below are excerpts from the:

- *1998 U.S. DEPARTMENT OF EDUCATION Indirect Cost Determination Guidance for State and Local Government Agencies" (Blue Book)*

- *1998 U.S. DEPARTMENT OF LABOR Guide for Indirect Cost Rate Determination, Cost Principles and Procedures for Nonprofit Organizations*

♦ WHAT ARE INDIRECT COSTS?

Indirect costs represent the expenses of doing business that are not readily identified with a particular grant, contract, project function or activity, but are necessary for the general operation of the organization and the conduct of activities it performs. In theory, costs like heat, light, accounting and personnel might be charged directly if little meters could record minutes in a crosscutting manner. Practical difficulties preclude such an approach. Therefore, cost allocation plans or indirect cost rates are used to distribute those costs to benefiting revenue sources.

Looking at it another way, indirect costs are those costs that are not classified as direct. Direct costs can be identified specifically with particular cost objectives such as a grant, contract, project, function or activity. Direct costs generally include:

1. Salaries are wages (including vacations, holidays, sick leave, and other excused absences of employees working specifically on objectives of a grant or contract – i.e., direct labor costs).

2. Other employee fringe benefits allocable on direct labor employees.

3. Consultant services contracted to accomplish specific grant/contract objectives.

4. Travel of (direct labor) employees.

5. Materials, supplies and equipment purchased directly for use on a specific grant or contract.

6. Communication costs such as long distance telephone calls or telegrams identifiable with a specific award or activity.

♦ WHAT IS AN INDIRECT COST RATE?

An indirect cost rate is simply a mechanism for determining fairly and conveniently within the boundaries of sound administrative principle, what proportions of

Departmental/organization administration costs each programs should bear. An indirect cost rate represents the ratio between the total indirect costs and benefiting direct costs, after excluding and or reclassifying unallowable costs, and extraordinary or distorting expenditures. (i.e., capital expenditures and major contracts and subgrants). The indirect costs in the numerator of the equation should bear a reasonable relationship to the direct costs from the denominator. This will allow for each program or activity represented in the direct costs base to assume their fair share of indirect costs when the rate is applied.

♦ HOW ARE INDIRECT COST RATES DETERMINED?

The cognizant Federal agency is responsible for approving indirect cost rates for recipients based on an indirect cost proposal submission. The indirect cost proposal or cost allocation plan should:

1. Identify all the activities carried on by the Department or unit and their attendant costs. All activities must be included regardless of the source of funds used to pay for them.

2. Incorporate those costs allocated to the departments or units through the central service cost allocation plan.

3. Classify the activities and their costs as direct or indirect.

4. Eliminate from indirect cost capital expenditures and those stipulated as unallowable by OMB Circular or program legislation.

5. Compute the rate by dividing the total remaining indirect costs by the direct cost base selected for distribution of the indirect costs. The most frequently used base is Modified Total Direct Costs (MTDC). Step 4 will require judgement on whether to "exclude" any disallowed or distorting costs or reclassify those costs to the direct cost base. The determining factor is if the cost at issue generates overhead or benefits from indirect costs, then it should be reclassified to the base and allocated a fair share of indirect costs. Additional guidance follows on how to obtain an approved indirect cost rate.

♦ QUESTIONS AND ANSWERS APPLICATION OF PRINCIPLES FOR <u>STATE AND LOCAL GOVERNMENTS</u> - ABOUT HOW TO PREPARE YOUR INDIRECT COST PROPOSAL FOR THOSE SUBJECT TO OMB CIRCULAR A-87

QUESTION: Is OMB Circular A-87 mandatory for use by both states and local governments?

ANSWER: Yes. Paragraph 3, Section A, Attachment A of the Circular states that these principles will be applied by all federal agencies in determining costs incurred by governmental units under federal grants, cost reimbursement type contracts, and cooperative agreements (including subgrants and subcontracts) except those with (1)

publicly-financed educational institutions subject to OMB Circular A-21, and (2) programs administered by publicly-owned hospitals and other providers of medical care that are subject to requirements promulgated by the sponsoring federal agencies.

QUESTION: OMB Circular A-87 states that it does not apply to grants and contracts with (1) programs administered by publicly-owned hospitals and other providers of medical care that are subject to requirements promulgated by the sponsoring federal agencies. What is the intent of this statement and how does it affect the reimbursement of costs?

ANSWER: Federal cost principles are designed to be compatible with the organizational structure, accounting systems and programs conducted by specific types of organizations which perform federal grants and contracts. OMB Circular A-87 was designed to be compatible with the type of operations conducted by state and local government. The organization and operations of colleges and universities differ markedly from that of state and local governments and, hence, there are special cost principles for them (OMB Circular A-21). These principles recognize state and local central service costs and departmental indirect costs allocable under the procedures of OMB Circular A-87.

QUESTION: Will the indirect costs arrived at by the application of the indirect cost rate percentage be reimbursed to state and local governments?

ANSWER: The indirect costs which are determined to be associated with federal programs in accordance with the procedures in OMB Circular A-87 will be recognized as part of the total cost of the federal projects, except where restricted or prohibited by law. The extent to which such costs are reimbursed is a matter for determination between the federal awarding agency and the recipient state or local unit of government.

♦ **FEDERAL COGNIZANCE:**

QUESTION: Can another federal agency question the costs included in a central service cost allocation plan submitted to and approved by a cognizant agency?

ANSWER: Cognizant federal agencies will coordinate the approval of central service plans with the other federal agencies affected. Accordingly, federal agencies will accept, as part of the costs of a particular state or local government agency, those costs represented as central service costs, provided they are in accord with the amounts set out in the negotiation agreement signed by the representatives of the state or local government and the cognizant federal agency.

QUESTION: Where can states and local governments receive additional information or clarification on the implementation of OMB Circular A-87?

ANSWER: States and local governments should contact the federal agency that has been assigned cognizance for either central service cost allocation plans or individual government department indirect cost proposals.

♦ DEFINITIONS:

QUESTION: To what does the expression "cost allocation plan" refer?

ANSWER: A cost allocation plan refers to a document that identifies, accumulates and distributes allowable costs to grants and contracts and identifies the procedures used in making such distribution. It refers to both the central service cost allocation plan which is used to allocate the costs of central government services to benefiting government departments and the indirect cost proposals of those departments or units performing grants and contracts.

QUESTION: What is an indirect cost rate?

ANSWER: An indirect cost rate is the ratio of an organization's indirect costs to some element of its direct costs, e.g., direct salaries and wages. Once determined, the rate is used to compute grantee indirect cost entitlement. The entitlement is accomplished by multiplying the indirect cost rate by the direct salaries and wages charged to a grant or contract. An indirect cost rate is the net product of an indirect cost rate proposal.

♦ PREPARATION AND USE OF PLANS:

QUESTION: Who is responsible for the preparation of state and local central service cost allocation plans and indirect cost proposals?

ANSWER: It is the responsibility of each state and local government to prepare timely central service cost allocation plans and indirect cost proposals where indirect cost reimbursement is sought.

QUESTION: Must the indirect cost proposal or the central service cost allocation plan be prepared centrally for each state or local department performing under federal grant programs?

ANSWER: There is no requirement that an indirect cost proposal be prepared by any designated state or local government organization. Proposals may be prepared by each of the government departments performing under federal grants or they may be prepared in a central office. However, while the state or local central service cost allocation plan need not be prepared centrally, it must be prepared as a single document.

QUESTION: How will a central service plan be used?

ANSWER: The central service plan is used to distribute allowable central service costs to each of the individual government departments benefited, in order that they might include them in their indirect cost proposal.

♦ SPECIFIC ITEMS OF COST:

QUESTION: How can a grantee distinguish between a direct cost and an indirect cost?

ANSWER: There is no universal rule for classifying costs as direct or indirect. Generally speaking, a direct cost is one that is incurred specifically for one activity. Indirect costs are of a more general nature and are incurred for the benefit of several activities. Consequently, some allocation technique must be used to distribute these indirect costs to the several direct functions benefited. Once a grantee makes an election and treats a given cost as direct or indirect it must apply that treatment consistently and may not change during the fiscal year.

QUESTION: Some grant programs are awarded to the Office of the Governor of a state, to the Chief Executive of a political subdivision, the Count Supervisor, City Council, School Board or other similar type of body. Are these grants precluded from covering indirect costs under the Circular?

ANSWER: The general expenses required to carry out the overall responsibilities of these officers are unallowable. Attachment B, Section 23 of the Circular identifies them as general government expenses, and therefore an unallowable cost. However, if special identifiable expenses were incurred to satisfy a federal grant or contract agreement, they would be allowed if they otherwise met the standards of allowability provided in the Circular.

QUESTION: Is it permissible to allocate costs (either directly or indirectly) on the basis of revenue or on the basis of funds available under federal grants or contracts?

ANSWER: No. The allocation of costs by either of these methods is unacceptable. Cost must be allocated on the basis of costs incurred under federal grants or contracts. Restricted Indirect Cost Rates and Supplement not Supplant Requirements Background Many of the large educational entitlement programs that provide funds to state and local jurisdictions were created by legislative statute which require that the federal funds be used to "supplement and not supplant" on going educational services. This means that state and local agencies have tax revenue or other financial resources of their own to finance the education of their children. The federal government wants to help them achieve greater levels of benefits or services through financial support. Without the "supplement not supplant" provision, state "X" could simply reduce its support of educational service to the extent of the newly available federal funding. This means state "X" could release local funds for other purposes, like tax relief or non-educational projects or other programs. Looking at it another way, without the supplanting prohibition a county could substitute federal money for tax revenue already generated to fund schools. The tax revenue windfall would be available to build other state projects (e.g., sewage treatment plants) and the federal funds would never reach the classroom as intended. To place the supplanting bar in proper context, it is best to equate the education of state citizenry with other basic functions of state government (e.g., utilities like police and fire departments).

QUESTION: What are Restricted Rates?

ANSWER: Restricted rates are special rates established to incorporate these provisions of program legislation that bar supplanting. The formula limits the general management costs that can be placed in the indirect cost pool (numerator) and requires a modified total direct cost (MTDC) base (denominator). For more information see Restricted Rates listing.

QUESTION: What is the practical effect of the restricted indirect cost rate formula?

ANSWER: The indirect cost determination effort for federal financial participation is viewed as a "funneling process." The first step requires the state and local unit of government to segregate the accounting of costs between indirect and direct with full cost reimbursement in mind. However, there is a paring down of the full cost reimbursement concept, when Office of Management and Budget (OMB) Circular A-87 is applied to adjust the indirect cost pool and direct cost base for unallowable costs and distorting cost items that do not benefit from or generate overhead. The restricted indirect cost rate determination further filter out costs that would be incurred by the state or local unit of government with or without federal influence. Conversely, costs that benefit program operations or relate to organizational units (components) are not general management costs but rather "other direct costs" for rate computation purposes. Costs associated with activities under organizational units that are not for Department level management also are not accepted as general management costs. Therefore, in a restricted rate setting indirect costs are purged to leave just "organization-wide" general management costs at the grantee level (e.g., bookkeeping, accounting, payroll, auditing, procurement, and personnel). These Departmental level general management costs are refined again to exclude costs associated with the Chief Executive Officers, their immediate officers, and space costs. These costs are then reclassified from indirect to the MTDC base for rate computation purposes.

QUESTION: Who are the Chief Executive Officers?

ANSWER: There are two types of Chief Executive Officers. One is the Chief Executive Officer of the grantee. This person is the individual who is the head of the executive office at the grantee who exercises overall responsibility for the operation and management of the organization. At the grantee level, the Chief Executive Officer's immediate office includes any Deputies or similar office, along with the immediate support staff of these people. It is important to emphasize here that the Chief Executive Officer of the grantee is not the Governor or member of a Board of a similar elected or appointed body. Expenses for these positions are already unallowable as "costs of general and State and local government." The second type of Executive Officer is the supervisor of a component within the grantee.

QUESTION: What are Component Costs?

ANSWER: Generally, components are organizational units for both indirect and direct functions that exist one level below the organization unit. Depending on the organization, there may be circumstances where certain direction and control indirect functions would be properly accounted for in the indirect cost pool. However, if the indirect cost functional unit is one level below the Chief Executive Officer of the grantee (or his Deputy or similar position) then the head of the indirect cost component, her/his secretary, and travel and other related office costs should be removed from the indirect cost pool and classified to the MTDC base. In effect, those costs, in that organizational setting, are considered divisional administration applicable to that component with no distinction between indirect and direct functions.

QUESTION: What does the term organization-wide mean in the restricted indirect cost rate determination?

ANSWER: The term organization-wide should be taken to mean those Departmental level direction and control function costs that all recipients of grant funds have in common. The regulations describe accounting, payroll, personnel management as examples of organizational disciplines that every grantee or any organization must have. Often cross cutting educational activities (e.g., Curriculum Development, Pupil Data, Library Services, Evaluation Services, and School Services) are mistaken for indirect cost functions which are not for direction and control of the organization, but rather provide services to schools or students. Those cost centers are more analogous to specialized or program service functions, even if they have system-wide impact. Again, the restricted indirect cost rate determination accepts costs related to maintaining operations as a business concern, but not costs that finance the delivery of services that the state or local unit of government provides as part of its specific mission. When making a determination as to whether a cost is organization-wide, the state and local unit of government must evaluate whether the activity is more analogous to Departmental "direction and control" overhead, versus administration of program services. The question to be answered is: "Is this cost incurred for general management purposes or does the cost further functions that are the mission of the organization?"

QUESTION: Will the Government share in costs that are cross cutting but not for direction and control activity if they benefit federal programs?

ANSWER: Under restricted indirect cost rate programs, state and local governments are not guaranteed a dollar for dollar reimbursement of all overhead related to federal programs with supplement not supplant provisions. State and local units of government must assume the financial obligation for costs that they normally would not in a normal federal financial relationship. The restricted indirect cost determination accomplishes a marginal distribution of administrative costs required to implement federal assistance.

QUESTION: Can costs for Divisional Administration under indirect and direct components be billed directly to federal programs?

ANSWER: Generally, such costs are the financial obligation of the state and local government. The only exception would be if the ED Grant Award official ruled the costs and the position were specifically required for federal financial participation.

QUESTION: Space type costs are accepted in a usual indirect cost environment. How are they accounted for in the restricted indirect cost formula?

ANSWER: There are two exceptions to Occupancy and space maintenance costs. One is if the state and local unit of government can identify that portion of space that supports allowable indirect cost personnel, then those limited costs may be included with allowable general management costs. The second exception would be if federal financial participation required the state and local government to rent additional space to carry out a government mandate.

QUESTION: May the space costs that are reclassified to the other direct cost base be recovered through direct billings?

ANSWER: No. These space costs are the financial responsibility of the organization.

QUESTION: When occupancy costs are part of the approved statewide costs, how are they treated for Restricted Rate purposes?

ANSWER: They are disallowed, except where allowable under 34 CFR 76.568 (b). The disallowed amount is not placed in the base, because these costs are not incurred by the recipient.

- **QUESTIONS AND ANSWERS FOR <u>NONPROFIT ORGANIZATIONS</u> - COMMONLY ASKED QUESTIONS - ABOUT HOW TO PREPARE YOUR INDIRECT COST PROPOSAL**

QUESTION: What do we do if some grants/contracts do not provide for any indirect costs or provide for indirect cost rates that are lower than those established, provisional or final?

ANSWER: All indirect costs, using the approved rate, must be allocated to all grants/contracts regardless of any restriction or funding limitations. Any allocable indirect costs that exceed any administrative or statutory restrictions on a specific Federal grant/contract may not be shifted to other Federal grants/contracts, unless specifically authorized by legislation. Non-Federal revenue sources must be used to pay for these unrecovered costs.

QUESTION: Will DOL assist grantees/contractors in obtaining proper approval of the indirect cost rate from other Federal agencies and State and local units of Government?

ANSWER: The Office of Cost Determination, DOL, will be available to explain to other organizations the methodology used in development of the grantees contractors indirect

cost rate. However, the funding of indirect costs is subject to approval of Government authorized representatives and contracting officers of the respective organization. Under most circumstances, other Federal agencies will recognize and pay a grantees/contractors approved indirect cost rate. The Cognizant Federal Agency cannot, however, require State or units of local Governments to recognize an approved indirect cost rate.

QUESTION: In the event that a grantee/contractor under expends that total grant/contract but exceeds the ceiling placed on the indirect cost by DOL, can the excess indirect cost be recovered?

ANSWER: No. The ceiling on the indirect cost was included in the agreement to limit the amount of grant/contract funds used for indirect cost purposes by the grantee/contractor. This condition was known by the grantee/contractor before any grant/contract funds were expended.

QUESTION: Can our indirect cost rate proposal be based only on Federal funds since it only represents 15% of our total revenue?

ANSWER: No. Your indirect cost rate proposal must be accompanied by a schedule of costs incurred for all projects, Federal and non-Federal, and the amount of the proposed allocation base must tie-in with the applicable direct cost base for all projects.

QUESTION: Is the cost of accrued annual leave allowable under OMB Circular A-122?

ANSWER: OMB Circular A-122, Attachment A, Paragraph 2E, states "To be allowable under an award, costs must be determined in accordance with generally accepted accounting principles". The Financial Accounting Standards Board issued Financial Accounting Standard Number 43 "Accounting for Compensated Absences" to establish uniformity in the accounting for annual leave pay. This standard requires employers to accrue during each accounting period to liability for compensated absences earned by employees during the period provided that all of the following conditions are met:

1. The employers obligation relating to employees rights to receive compensation for future absences is attributable to employees services already rendered;
2. The obligation relates to rights that vest or accumulate;
3. Payment of compensation is probable; and
4. The amount can be reasonably estimated.

The accrual of annual leave does not result in increased costs, but allows recognizing the cost in the proper accounting period to improve actual cost determination. In general, compensated absences are to accrued in the period in which they are earned rather than when they are paid. In order for accrued leave to be an allowable cost, the personnel policies of the organization must comply with the Financial Standard Number 43.

QUESTION: What is the difference between bid and proposal costs and fund raising costs and how does a grantee/contractor treat such costs in its indirect cost proposal?

ANSWER: Bid and proposal costs represent the salaries, consultant fees, pricing, postage, travel, etc. associated with an organizations preparation of bids, proposals and applications to perform specific tasks for remuneration under potential Federal and non-Federal grants, contracts or other agreements. An organization should treat bid and proposal expenses as allowable indirect costs subject to any limitations imposed by the Cognizant Federal agency. Fund raising cost represent the salaries, consultant fees, printing, postage, travel, etc. for associated with an organizations requests for private institutions or individuals for donation of funds for non-specific purposes. Fund raising costs are unallowable for Federal reimbursement purposes. However, this activity (cost objective) shall be allocated an appropriate share of indirect costs. Accordingly, fund raising costs are to be included in the distribution base used to compute an organizations indirect cost rate.

QUESTION: Can the audit costs under OMB Circular A-133 be recovered?

ANSWER: A-133 allows audit costs to be recovered as either direct or indirect costs in accordance with applicable cost principles. However, there is no special appropriation for audit costs. To recover audit costs, the organization must build them into the specific grant/contract documents (if direct) or into the overhead proposal (if indirect).

QUESTION: If the grantees policy is to capitalize equipment under the $5,000 threshold specified in A-122, do they need Federal approval prior to directly charging the grant with the cost of equipment?

ANSWER: No. The grantee is allowed to directly charge the Federal grant with the cost of equipment under the $5,000 threshold without obtaining prior Federal approval. This direct cost is usually classified as supplies in the reporting of Federal grant expenditures and, if applicable, must be in compliance with any budget limitations.

QUESTION: A grantee has contracted to update its computer network with its affiliates for a total cost of $50,000. Since each component; i.e., monitor, printer, personal computer, software, modem, etc., costs less than the $5,000 per unit threshold specified in A-122, can this "equipment" be charged to the indirect cost pool?

ANSWER: No. The components of the computer network make it useable for the purpose for which it was acquired and therefore establishes the "system" as a capital expenditure. Accordingly, this equipment can be appropriately charged to Federal grants either as direct or indirect cost, on the basis of depreciation or a use allowance as specified in A-122.

QUESTION: A grantee purchased a building in September, 1995 and refinanced its mortgage in September, 1998. Can the grantee now charge Federal programs with the interest incurred on this mortgage?

ANSWER: No. Interest on debt incurred to finance or refinance assets acquired before or reacquired after June 1, 1998 is not allowable.

QUESTION: When is a grantee required to prepare a cash flow statement prior to claiming interest expense on Federal programs?

ANSWER: A cash flow statement is to be prepared on an annual basis for debt arrangements over $1 million, unless an initial equity contribution to the asset purchase equals 24% or more. A non-profit organization shall reduce claims for interest expense by an amount equal to imputed interest earnings on excess cash flow, which is to be calculated in accordance with Paragraph 23,a(1)(f)(ii) of Circular A-122.

QUESTION: What is required of a grantee that sells its facilities and decides to rent office space in another facility at less cost to its Federal programs?

ANSWER: Substantial relocation of Federally-sponsored activities from a facility financed by indebtedness, the cost of which was funded in whole or part through Federal reimbursements, to another facility prior to the expiration of a period of 20 years, requires notice to the Federal cognizant agency for possible adjustment to future space costs charged to Federal programs.

QUESTION: What is the relationship of OMB Circular A-122, "Cost Principles for Non-Profit Organizations" and OMB Circular A-133, "Audits of Institutions of Higher Education and Other Non-Profit Institutions" in regard to indirect costs?

ANSWER: The compliance supplement for OMB Circular A-133 incorporates OMB Circular A-122. It sets forth the major compliance requirements that should be considered in an organization-wide audit of non-profit institutions receiving Federal assistance. The compliance supplement contains general requirements that shall be considered in all financial and compliance audits. Failure to comply with the general requirements could have a material impact on an organizations financial statements. One of these general requirements is presented in Appendix VII to OMB Circular A-133, "Allowable Costs/Cost Principles." According to this requirement, the Auditor is responsible for auditing direct and indirect costs to determine whether costs claimed are in compliance with OMB Circular A-122.

QUESTION: Can transactions with an affiliate affect allowable costs?

ANSWER: Yes. A problem may arise in transactions between parent organizations and their affiliates when the parent organization has an equity interest in the affiliate. When an equity interest exists, any profits made by the affiliate improve the equity interest of the parent. If an affiliate sells a good or service to the parent and the selling price includes a profit to the affiliate, the parents equity interest in the affiliate has been increased. If the parent then includes the purchase price as a direct or indirect charge to a Federal award, it has violated the OMB Circular A-122 cost principle that charges will be at cost and not include a profit factor. For example, suppose your organization (the parent) obtains accounting services from an affiliate and the parent organization has an equity interest in the affiliate. The fee that the parent pays to the affiliate must be based on the cost

incurred by the affiliate and the fee may not include a profit to the affiliate. If the fee does include a profit factor to the affiliate, the allowable part of the fee is limited to that portion which represents the cost to the affiliate exclusive of any profit factor.
This principle works in reverse as well. When an organization provides a good or service to an affiliate, the full cost of providing that good or service must be recovered from the affiliate and an appropriate credit must be applied to the indirect cost pool.

QUESTION: What is the period of time that an indirect cost rate agreement covers?

ANSWER: A provisional indirect cost rate is negotiated to cover a one year period. However, because of the time lapse between the submission and approval of a rate, provisional rates are usually established by DOL for a two year period. A final indirect cost rate agreement is negotiated to cover one fiscal year period after which a new final indirect cost rate must be negotiated for the subsequent fiscal year.

QUESTION: When a grantee/contractor is required by DOL to submit a closeout package prior to negotiating a final indirect cost rate, what is the procedure?

ANSWER: The grantee/contractor should prepare the closeout package using the approved provisional indirect cost rate and include a statement indicating that a provisional indirect cost rate was used pending negotiations of a final closeout will be submitted.

QUESTION: What can the submitting organizations do to help the Federal Cognizant Agency facilitate their review of an indirect cost rate proposal?

ANSWER: If there are any questions concerning any aspect of the proposal, call the Federal cognizant agency rate negotiator to resolve the issue prior to formal submission. Also, if during a prior negotiation you agreed to take corrective action(s) on any issues, you must disclose the status of your action(s). Finally, you must inform the cognizant agency about all significant organizational or accounting changes and their impact. If these actions re taken, it could save time in getting the proposal negotiated.

QUESTION: What are some of the concerns the Federal agencies have about grantee/contractor submissions of indirect cost rate proposals?

ANSWER: The primary concern of Federal agencies is the receipt of incomplete documentation. Indirect cost proposals do not provide sufficient detail to explain the functions and the benefits associated with the costs being allocated. An additional concern to Federal agencies is an indirect cost proposal that is not reconcilable to a budget or a financial statement and contains no explanation of the difference.

- **FOR <u>NONPROFIT</u> ORGANIZATIONS, FORM LETTER ABOUT - "HOW TO PREPARE YOUR INITIAL INDIRECT COST PROPOSAL."**

Re: Indirect Cost Information

Dear:

The following guidance is intended to help organizations properly develop their initial indirect cost proposal.

1. Prepare a direct and indirect cost policy statement (narrative). Each organization should prepare a written policy which outlines the costs that it considers direct, the costs it considers indirect and the rationale to support those costs.

2. Prepare a personnel costs worksheet. When preparing a "Provisional Indirect Cost Proposal," current approved budget figures should be used in the preparation of the personnel costs worksheet. When a "Final Indirect Cost Proposal" is prepared, actual personnel costs should be used.

3. Prepare an allocation plan of personnel costs. This document reflects the estimated personnel efforts for each cost objective. A column should be made for each cost objective of the organization. Then, the percentage of time per position should be spread under the appropriate cost objective, making sure that 100 percent is allocated for each position.

4. In this example, each salary is prorated to the cost objective according to the appropriate percentage. The total direct salary costs for each objective are obtained by adding the salary amounts in each cost objective column. Office of Management and Budget Circular A-122. The organization must maintain a time distribution system for use by employees whose time is charged to one or more cost objectives. The time distribution records must be available for review by Federal cost negotiators and auditors.

5. Prepare a statement of employee benefits. This document should contain the estimated/actual costs of the items in the employees benefit pool. Employee (fringe) benefits should follow the salary of the individual and are a consideration in the determination of the reasonableness of the compensation of the individual. Fringe benefits should be accrued in the period incurred, including accrued leave if employees have and irrevocable right to be compensated during employment or upon termination of employment. Generally, the cost of annual leave is considered a cost to the extent of actual compensation to employees.

Normally, indirect cost rates are determined and made formal by binding agreement with the Federal government ahead of actual use. So they are largely an estimate of future indirect costs based on past experience.

Your interest in the indirect cost determination process is appreciated. If further information or assistance in this matter is required, please contact this office at (202) 606-5000 extension.

Sincerely,