

Indirect Costs

Uses, Responsibilities and Restrictions



What are Indirect Costs and Who Calculates the Rate?

Indirect costs (IDC) 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 Local Education Agency (LEA) and the conduct of activities it performs. Direct costs, by contrast, are those costs which can be easily, obviously, and conveniently identified with specific activities or programs. The U.S. Department of Education has a brief training on IDC that provides relevant information.

An indirect cost rate (ICR) 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). [\[ED Indirect Cost Overview\]](#) These exclusions and distorting items are discussed in the sections below.

Each LEA's ICR is calculated annually by the CDE Public School Finance Unit (PSFU) based on an LEA's Finance December data pipeline submissions. To understand how an LEA's Fixed with Carry Forward Indirect Cost Rate is calculated, please visit this [link](#).

Note, the Fixed with Carry-Forward indirect cost calculation method, used to determine an LEA's Restricted and Non-restricted rates (in the Finance December data collection), is reviewed, and approved by the US Department of Education every four years.

Exclusions and Distorting Expenditures

The indirect cost calculation performed by PSFU as indicated above starts with an LEA's total direct costs and then removes any distorting items, either in whole or in part, to arrive at what is known as the Modified Total Direct Costs (MTDC) for an LEA. The Uniform Grant Guidance (UGG) defines MTDC at 2 CFR 200.1 as,

"... all direct salaries and wages, applicable fringe benefits, materials and supplies, services, travel, and up to the first \$25,000 of each subaward [contract] (regardless of the period of performance of the subawards under the award). MTDC excludes equipment, capital expenditures, charges for patient care, rental costs, tuition remission, scholarships and fellowships, participant support costs and the portion of each subaward(contract) in excess of \$25,000 ..."

Equipment, capital expenditures are fully excluded from the indirect cost calculations because they tend to be distorting in nature.

- Equipment is defined as tangible personal property having a useful life of more than one year and a per-unit acquisition cost equal to or exceeding the lesser of the capitalization level established by the LEA for financial statement purposes, or \$5,000 (2 CFR 200.1). Examples include the cost of equipment plus any expenditures incurred to place the equipment in service such as delivery and installation services.

Note, items with an initial individual cost that is less than \$5,000 (or the LEA's capitalization threshold) that require additional peripherals necessary for the item to be placed in service must be capitalized as equipment if the cost of the peripherals cause the overall cost of the item to meet or exceed \$5,000 or the LEA's capitalization threshold. Examples include network servers that require multiple pieces of equipment, blades, storage etc., necessary for the server to properly function and be placed in service (i.e., the server could not work without the additional parts).

- Capital expenditures are defined as expenditures to acquire capital assets or expenditures to make additions, improvements, modifications, replacements, rearrangements, reinstallations, renovations, or alterations to capital assets that materially increase their value or useful life (2 CFR 200.1). Examples include labor and materials related to capital construction projects.

In addition, certain contracted services are distorting in nature and the ICR must only be applied against the first \$25,000 of costs associated with these contracts. The underlying rationale is that if a third-party performs works under a contract to provide services for the LEA, then the LEA does not typically provide the same level of administrative support as it would if performing the work itself (e.g.- payroll and accounting costs, supplies, management costs, overhead/facilities, etc.).

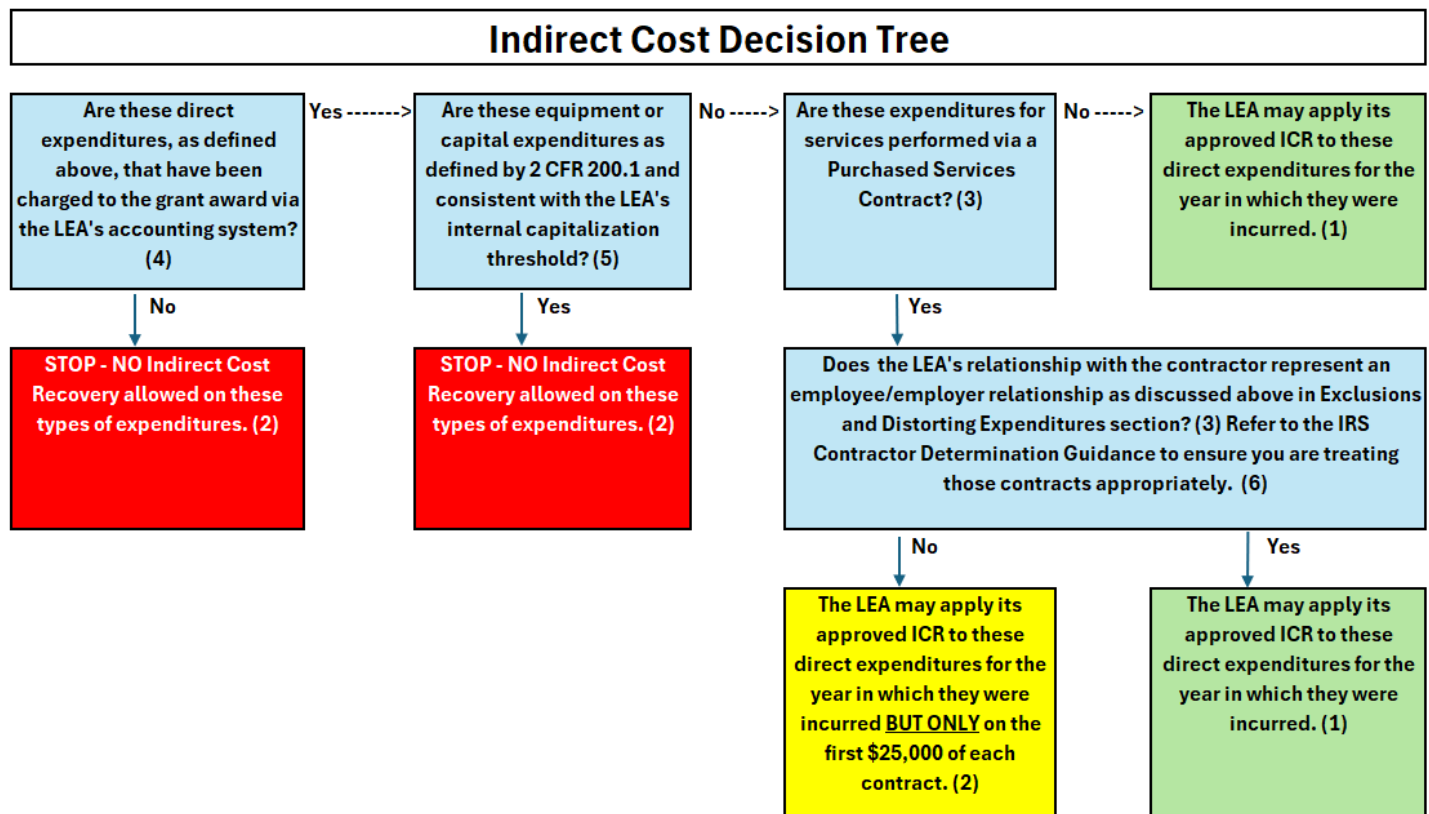
- As an example, if an LEA chooses to contract with an outside vendor to provide transportation services, they no longer handle payroll for bus drivers or the payment of invoices to a fuel supplier. Therefore, it is considered distorting for the entire cost of providing transportation to be included in the application of an ICR for the LEA.

By contrast, if an LEA contracts with a vendor to provide services augmenting current staffing (perhaps in instances where the labor pool or special skills are not available at the LEA or surrounding community), the LEA must examine the scope of work to determine the nature of its relationship with its service subcontractor and the existence of any behavioral or financial control. LEAs should utilize [IRS Tax Topic no. 762 Independent Contractor vs. Employee](#) as a helpful resource for this analysis.

- As an example, if an LEA hires a tutor from a temporary service, they must examine the relationship between the tutor and the LEA to determine the degree of control and independence. The relationship becomes more akin to that of an employer/employee if the LEA can answer “Yes” to questions such as,
 - Does the LEA have a right to direct and control what work is accomplished and how the work is done, through instructions, training, or other means (behavioral control)?
 - Does the LEA provide items such as a workspace, supplies, and a set work schedule to the tutor/nurse, counselor, etc. (financial control)?
 - Does the LEA provide the tutor with employee-type benefits, such as insurance, a pension plan, vacation pay, or sick pay (relationship of the parties)?

In these instances, the LEA does provide a similar level of administrative support for the contracted services as they would have if they provided the services themselves and the \$25,000 exclusion would not apply.

Note, the threshold of \$25,000 may change with new UGG guidance going into effect 10/1/24. If the threshold is updated, this document will be updated as well.



(1) Each LEA has a restricted and an unrestricted rate. See LEA Grant Award Letter (GAL) for appropriate rate.

(2) [IDC Restriction Guidance](#)

(3) [Professional Services](#)

(4) [2 CFR 200.1 Expenditures](#)

(5) [Capitalization](#)

(6) [IRS Contractor Determination Guidance](#)

ICR Uses and Reimbursement Requests

Indirect cost recovery is designed for LEAs to offset various overhead and operating costs already incurred in the general course of doing business by applying an approved ICR to the identified MTDC for the applicable award (as discussed above). Once recovered, the cash "in the door" is not restricted by any federal rules since it is merely a reimbursement of incurred expenditures.

The vehicle used by CDE for indirect cost recovery is the Request for Reimbursement. The indirect costs calculated as described above would be included with the applicable direct costs being requested at any given time. Please note, as PSFU calculates the ICR annually, the LEA must ensure the appropriate ICR is applied to MTDC from the corresponding fiscal year. For instance, the ICR approved for use in fiscal year 2021–22 would be used for expenditures incurred July 1, 2021, through June 30, 2022, and the ICR approved for use in fiscal year 2022–23 would be used for expenditures incurred from July 1, 2022, until January 31, 2023. **Remember, ICR CANNOT be claimed on expenses that have NOT yet been incurred.**

Indirect Cost Recovery Adjustments

The automatic calculations inherent in the ESSER, Consolidated Application for ESEA funds, and GAINS systems are based on object codes. Those calculations exclude object codes such as 0730 Equipment and 0594 Purchased Services from Districts and Charter Schools, but the systems have no way to identify and exclude distorting items, such as service contracts recorded in 0300 Purchased Professional and Technical Services that are subject to the \$25,000 limitation discussed above. Therefore, LEAs must manually calculate their IDCs and use the override feature available in these systems, if needed, to ensure their IDCs have been properly budgeted. For a complete listing of object code and other exclusions in the PSFU ICR calculations, LEAs can find their specific Indirect Cost Report at this [link](#).

If errors are discovered either by the LEA's manual calculation discussed above or by CDE staff, the LEA is expected to make the necessary adjustments in their accounting systems to ensure compliance. Should these adjustments result in additional funds from a specific program, the LEA must submit a Post Award Revision (PAR) to identify other allowable costs to account for the difference. Replacement activities and costs must be allowable under the impacted programs, reasonable, and necessary to meet the program intent (i.e. - be allocable to the impacted program).

The CDE Grants Fiscal Management Unit (GFMU) and PSFU have put together some example entries on how these indirect adjustments can be made:

Initial calculation (with correcting entries below)

Aggregated Total of EXP

0580	\$ 6,000.00	
0300	\$30,000.00	(Error - Only up to \$25k per aggregated total by grant)
0610	\$ 3,000.00	
0730	\$ 6,000.00	(Error - No indirect on capital)
	<u>\$45,000.00</u>	

ICR	10.5%
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Total indirect initially charged	\$ 4,725.00	<i>Includes capital expenditures and full amount of contract (amounts in excess of \$25k) in error</i>
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It is the district's choice when booking indirects to use the Revenue Method or the Abatement Method:

Revenue method

DR - Indirect Exp	22 - XXX-00-XXXX-0869-XXX-4010	\$4,725.00
CR - Pooled Cash	22 - XXX-00-XXXX-8100-XXX-0000	\$4,725.00
DR - Pooled Cash	10 - XXX-00-XXXX-8100-XXX-0000	\$4,725.00
CR - Revenue	10-000-00-0000-1972-000-0000	\$4,725.00

Abatement Method

DR - Indirect Exp	22 - XXX-00-XXXX-0869-XXX-4010	\$4,725.00
CR - Pooled Cash	22 - XXX-00-XXXX-8100-XXX-0000	\$4,725.00
DR - Pooled Cash	10 - XXX-00-XXXX-8100-XXX-0000	\$4,725.00
CR - Indirect Exp	10-000-00-0000-0869-000-0000	\$4,725.00

Determination of the correct base amount (MTDC - Modified Total Direct Cost) to charge Indirects:

Aggregated Total of EXP

0580	\$ 6,000.00	
		(Correction - Only up to \$25k per aggregated total by grant
0300	\$25,000.00	- reduced 30k by 5k to get to 25k)
0610	\$ 3,000.00	
0730	\$ -	(Error - No indirect on capital)
	<u>\$34,000.00</u>	

ICR 10.5%

Total allowable indirect \$ 3,570.00

Indirects Originally Charged	\$ 4,725.00
Correct Amount	<u>\$ 3,570.00</u>
Difference	<u>\$ 1,155.00</u>

Correcting entries - to remove indirect costs charged on object 0730 and contracts exceeding \$25k

Revenue method		
DR - Pooled Cash	22 - XXX-00-XXXX-8100-XXX-0000	\$1,155.00
CR - Indirect Exp	22 - XXX-00-XXXX-0869-XXX-4010	\$1,155.00
DR - Revenue	10-000-00-0000-1972-000-0000	\$1,155.00
CR - Pooled Cash	10 - XXX-00-XXXX-8100-XXX-0000	\$1,155.00
Abatement Method		
DR - Pooled Cash	22 - XXX-00-XXXX-8100-XXX-0000	\$1,155.00
CR - Indirect Exp	22 - XXX-00-XXXX-0869-XXX-4010	\$1,155.00
DR - Indirect Exp	10-000-00-0000-0869-000-0000	\$1,155.00
CR - Pooled Cash	10 - XXX-00-XXXX-8100-XXX-0000	\$1,155.00

Note: If a district is reporting the Grant Activity in fund 10, the pooled cash accounts in the entry would be eliminated, as it would all be fund 10. If the indirect cost is in a prior fiscal year and there is nothing to net the indirect cost against, a negative indirect expenditure will create an issue with the data pipeline. School Finance must be made aware if there is a negative indirect expenditure to discuss next steps with the data pipeline and can 'release' the error after they are made aware of the issue and the reason.