

New Jersey School District and Charter School Indirect Cost User Manual

Information Sources:

Office of Management and Budget (OMB) Circular A-87 (revised 5/10/2004) is available at http://www.whitehouse.gov/omb/circulars_a087_2004#atta and establishes the principles and standards for determining costs for federal awards carried out through grants, cost reimbursement contracts, and other agreements with State and local governments. OMB Circular A-87 in conjunction with the Implementation Guide - OMB Circular A-87 available at: http://www.pasrrassist.org/sites/default/files/attachments/13-09-18/Implementation%20Guide%20for%20OMB%20Circular%20A-87_2004.pdf provides the framework for the Indirect Cost Agreement between the USDOE and the NJDOE.

OMB Circular A-87 and related guidance provided by the U.S. Department of Education at <http://www2.ed.gov/about/offices/list/ocfo/fipao/guideigcwebsite.pdf> and at <http://www2.ed.gov/about/offices/list/ocfo/fipao/bluebookqas.html> provides information regarding the two categories of indirect cost rates; Restricted Indirect Cost Rates and Unrestricted Indirect Cost Rates. The primary reason for multiple rates is that 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. Without the "supplement not supplant" provision, states could simply reduce support of educational service to the extent of the newly available federal funding or could substitute federal money for tax revenue already generated to fund schools. School districts and charter schools that want to charge indirect costs to a federal grant or program that contains "supplement and not supplant" language must use their approved restricted indirect cost rate. The restricted rate is always lower than the unrestricted rate.

Definitions:

Direct costs - are incurred specifically for a program or other cost objective, and can be readily identified to a particular objective such as school food service. For example, if your school district or charter school manages a nonprofit school food service account, direct costs may include, but are not limited to, food, the wages and salaries of the staff working in the school food service, and supplies specifically used in the school food service. (2 CFR Part 225, Appendix A, section E.1. describes direct costs as, "those that can be identified specifically with a particular final cost objective.")

Indirect costs – are incurred for the benefit of multiple programs, functions, or other cost objectives and therefore cannot be identified readily and specifically with a particular program or other cost objective. Indirect costs typically support administrative overhead functions such as accounting, payroll, purchasing, facilities management, and utilities.

Allocation – is the math used to assign indirect costs to particular federal programs and grants so that each program or grant bears a portion of the indirect costs that is commensurate with the benefit received from those costs. It is important to note that in order to charge a cost to a federal assistance program or grant as a direct or indirect cost, that cost must first be an allowable cost as established by Federal cost principles.

Federal Cost Principles:

<u>Type of Organization that Receives an Award or Subaward:</u>	<u>Source of Applicable Cost Principles:</u>
State, or local governments (charter schools and school districts)	2 CFR Part 225 (OMB Circular A-87)
Nonprofit Organization	2 CFR Part 230 (OMB Circular A-122)

School districts and charter schools will generally look to 2 CFR Part 225 (OMB Circular A-87) for guidance regarding costs incurred and the relationship of those costs in the determination of the district or charter school indirect cost rates. Costs determined to be allowable under the Federal Cost Principles, direct and indirect, must be identified in a consistent manner. That is, costs identified as indirect costs, must be treated as indirect costs across the entire scope of that school district or charter school’s programs and activities.

Why do New Jersey School Districts and Charter Schools Receive Two Rates – A Restricted Rate and an Unrestricted Rate?

Restricted rates are established to incorporate the provisions of program legislation that bar supplanting. The restricted indirect cost rate formula is described at 34 CFR 75.564 and 76.565. The formula limits the general management costs that can be included in the indirect cost pool (numerator) and requires adjustments to the Modified Total Direct Costs (MTDC) base (denominator) used to determine rates. **Whenever the federal grant or federal program contains language prohibiting the use of federal funds to supplant non-federal funds, the RESTRICTED INDIRECT COST RATE IS THE ONLY RATE THAT MAY BE APPLIED TO THE FEDERAL GRANT OR FEDERAL PROGRAM.** The restricted rate will always be less than the unrestricted rate. When the federal grant or federal program language doesn’t contain "supplement and not supplant" language, the school district or charter school may elect to use either the unrestricted or the restricted indirect cost rate. School districts and charter schools are encouraged to contact the grants manager or program coordinator when questions arise as to which rate to apply to a federal program or federal grant.

Application of Restricted and Unrestricted Indirect Cost Rates to Federal Grants and Programs

Example #1 – Title “YYY” Grant:

School districts and charter schools are encouraged to discuss the charging of indirect costs to a federal grant with the grant administrator. The grant administrator is knowledgeable about the grant, and will be aware of the specific requirements of the grant such as whether the grant contains a maximum rate that may be used in the determination of the indirect cost charge. In general, the amount available for application to the indirect cost rate is determined by subtracting excluded costs (items of equipment, subcontracts in excess of \$25,000, and flow-through funds) from the grant award. Note that only the first \$25,000 of a sub-award is included in the Base of Application, and only during the first year of the sub-award. Amounts exceeding \$25,000 during the first year, as well as the **entire sub-award amounts during subsequent years**, are excluded

from the Base of Application. This adjustment is made because the cost of administering a procurement contract is substantially the same regardless of the value of the contract. The cost is presumed not to exceed \$25,000 per contract. **Therefore, the value of each contract beyond the first \$25,000 must be excluded.** The remaining amount is the net available for both indirect and direct costs.

To illustrate, the district is in year one of the grant award. The award language contains "supplement and not supplant" language so only the restricted rate may be used. The total grant award is \$1,020,000 of which \$1,395 is budgeted for equipment purchases and \$100,000 is budgeted for subcontract payments. To determine the amount available for indirect and direct costs, the grant award (\$1,020,000) is reduced by budgeted capital equipment purchases (\$1,395) and by budgeted subaward payments in excess of \$25,000 (\$100,000 - \$25,000 = \$75,000). The net amount is then divided by the combined percentage of 100.00 percent plus the applicable indirect cost rate percentage. The school district or charter school has been approved by the NJDOE to use a restricted indirect cost rate of 5.45%. The maximum indirect cost rate per the grant documents is 10%.

Grant Award	\$1,020,000
Less: Capital Outlay.....	\$1,395
Less: 1 st Year Subaward in Excess of \$25,000.....	\$75,000
Net Available for Indirect and Direct Cost	\$943,605

Amount Available to be Assessed Indirect Costs

\$943,605 ÷ 105.45%
 \$943,605 ÷ 1.0545
 \$894,836
 =====

Indirect Cost Dollar Amount =

\$894,836 x 5.45% = Indirect Cost Dollar Amount
 \$894,836 x .0545 = Indirect Cost Dollar Amount
 \$ 48,769 = Indirect Cost Dollar Amount

{ \$943,605 - \$894,836 = \$48,769 }

NOTE: The above example shows how to calculate the **maximum** amount of indirect costs that could be claimed against a grant; however, the amount of indirect costs actually paid for a fixed grant will depend on the actual amount of direct costs actually incurred for the grant. In no case can the amount of actual direct costs plus calculated indirect costs plus capital outlay costs exceed the total amount of the fixed grant award. Grants that limit the amount charged as administrative costs can only charge indirect costs within the administrative cap.

Example # 2 Food Service Program:

The United States Department of Agriculture, Food and Nutrition Service, issued indirect cost guidance during July, 2011 available at http://www.fns.usda.gov/sites/default/files/SP41-2011_os.pdf . Nonprofit school food service account funds are limited to those expenses that are reasonable and necessary to provide quality meals for the National School Lunch Program (NSLP) and the School Breakfast Program (SBP). In general, the full cost of the NSLP and SBP include both direct and indirect costs. Direct costs are incurred specifically for the NSLP and

SBP, and can be readily identified to a particular school food service objective. School districts and charter schools are encouraged to consult Appendix B of 2 CFR Part 225 at: <http://www.gpo.gov/fdsys/granule/CFR-2012-title2-vol1/CFR-2012-title2-vol1-part225-appB/content-detail.html> which provides examples of typical direct costs chargeable to the nonprofit food services account. Allocation of indirect cost is necessary because allocation identifies the portion of the “other” or “overhead” costs that also benefit the school food service.

For the nonprofit school food service fund, the indirect cost reimbursement is determined by multiplying the approved indirect cost rate (unrestricted or restricted may be used, but whichever rate is selected must be used for the entirety of the fiscal year) times the **direct cost base**. The department encourages the following reimbursement calculation be performed on a monthly basis. The formula your school business administrator must use to calculate your school district or charter school **direct cost base** at the end of a monthly billing period is:

- 1) Total expenditures for the nonprofit school food service fund for the month
- 2) Minus:
 - A) The value of commodities received for the month
 - B) Expenditures/accruals for food purchases for the month
 - C) Food service furniture/equipment expenditures/accruals for the month
 - D) Food Service Management Fees paid or accrued for the month
 - E) Expenditures/accruals for purchases, labor, or other costs posted to the general ledger as a direct cost of the school food service fund when the school district’s internal accounting policy for the type of cost results in the cost being charged as an indirect cost of any other program maintained by the school (costs are not consistently treated as discussed above**)
- 3) The result of 1) minus 2A) through 2E) equals the **direct cost base for the month**

The approved indirect cost rate (the district may choose to use either the unrestricted (maximum) or the restricted (minimum) for the entirety of the fiscal year) multiplied by the **direct cost base for the month (1 – 2(A through E) = 3)** results in the allowable indirect cost reimbursement that may be reimbursed to the general fund for the month. In selecting which rate to use, be aware that the total amount of indirect costs charged to food services for the fiscal year cannot result in a deficit in the nonprofit food service fund.

School districts and charter schools should be aware that a cost that is a direct cost for a particular school district or charter school may be an indirect cost at another school. For example, some school food authorities document the hours that custodians work cleaning food service areas such as the kitchen and serving areas, through a time reporting system (refer to 2 CFR Part 225, Attachment B, section 8.h, *Support of salaries and wages*). The time reporting system provides the exact hours a custodian cleans the food service area(s) and the other areas of the school. In this scenario, the school food authority may charge the custodial expenses for cleaning the school food service as a direct expense. All other programs benefiting from the “rest of the school” custodial services must then be charging custodial services as a direct expense as well. Alternatively, the custodial expenses may be charged as an indirect cost to the school food authority by including those costs in the indirect cost pool for the school district or charter school. To further explain, custodial expenses may be charged as a direct or indirect cost

by New Jersey school districts and charter schools as long as all custodial expenses are treated consistently for all activities of the school district or charter school. Because of the consistency requirement, a New Jersey school district or charter school may not charge custodial expenses as a direct cost to the school food authority (e.g. through a time reporting system) and as an indirect cost for other programs.

To further illustrate this point, typically, actual indirect costs may include district/school wide utility bills, janitorial services, trash services, etc. and are often paid from the school district's general fund. Unless the school district or charter school has separate meters, utility lines, or trash pickup to serve only the school food service, assigning the charges through indirect costs may be the only way to identify them as costs allocable to the nonprofit school food service. However, because of the consistency requirement with regards to treatment of costs, it is not as simple as dedicating utility lines or trash pickup to the school district's or charter school's federal assistance programs. When a separate utility or trash pickup (separately identifiable cost) is provided to a federal assistance program, such as the Child Nutrition Program (CNP), that cost may not be assigned to the CNP (or any other federal award) as a direct cost if the same cost incurred for the same purpose, in similar circumstances, has been allocated to other awards as an indirect cost. For example, it is not consistent treatment to charge utilities as an indirect cost for all programs except the CNP (which you charge as a direct cost) for which the school district or charter school has separate utility meters. **See Item "E" above.

To reiterate, child nutrition programs may use the unrestricted indirect cost rate as a maximum rate. It is recommended that on a monthly basis, the school business administrator determines the amount billed by applying the approved unrestricted indirect cost rate (maximum) or restricted (minimum) to the school food service's direct cost base. Once a rate is selected, that rate must be used for the entirety of the fiscal year. New Jersey school districts and charter schools generally will prepare a bill from the general fund to the program offices (e.g. the nonprofit school food service) for payment to the general fund.

Please note that indirect costs can only be recorded in the food service fund if there is an excess in the operating balance. School districts and charter schools may not complete a transfer from the general fund to the school food service fund (board contribution to cover a deficit) during a fiscal year in which indirect costs are charged to the school food service fund.

New Jersey school districts and charter schools should address questions regarding specific situations and what costs to include in their direct cost base to the New Jersey Department of Agriculture.

Example #3 – Special Education Medicaid Incentive (SEMI):

New Jersey school districts and charter schools participating in SEMI that also receive an approved indirect cost rate (restricted and unrestricted) will have an indirect cost factor included in their reimbursement calculated by the third party consultant. The third party consultant will be provided with your school district or charter school rates upon your districts completion of the Indirect Cost Rate Tool (ICRT) tool. The third party consultant will use the school district’s or charter school’s unrestricted rate to determine the reimbursement of indirect costs to be charged to the SEMI program. The following is an illustrative calculation of an indirect cost calculation for SEMI:

Step	Cost Report Element	Example Values
A	Total Direct Medical Service Costs (net of federal funds) (sum of annual payroll info, materials & supplies, and depreciation)	\$1,089,530
B	Direct Medical Service % (from RMTS)	65.00%
C	(Step A × Step B)	\$708,195
D	Out of District Tuition Costs	\$50,000
E	(Step C + Step D)	\$758,195
F	Indirect Cost Rate (17%)	1.17
G	(Step E × Step F)	\$887,088.15
H	Individual Education Program Ratio	50.00%
I	SEMI Medicaid Eligible Direct Service Cost (Step G × Step H) *This number is then compared to Medicaid Interim Payments Received to determine the gross settlement amount, of which we take 50% (the federal share) to reach a final settlement amount.	\$443,544.08

Entries to record indirect costs:

Sample Entries for Indirect Costs Being Transferred Between Funds (e.g. general fund and enterprise fund or special revenue fund)

It is not appropriate to classify indirect costs as expenditures. Indirect costs are simply a transfer of resources, and as such are classified as other financing sources/uses of funds in the governmental funds and as transfers in all other funds (GASBS 34, paragraph 88). Therefore, it is not appropriate to recognize revenues or expenditures for indirect costs for transfers between funds representing indirect cost charges. Note that federal program budgets and completion reports will allow indirect costs to be reported as a use of the grant.

Illustration

General Fund:

Dr. 10-132 Interfund Accounts Receivable \$XXX

Cr. 10-5XXX Food Service Fund/Special Revenue Fund – Indirect Cost Allocation \$ XXX

To establish the receivable from the food service fund (or special revenue fund) for the transfer of indirect costs – “other financing source”

Dr. 10-101 Cash \$XXX

Cr. 10-132 Interfund Accounts Receivable \$XXX

To record receipt of indirect costs in the general fund from the food service fund or special revenue fund

Food Service Fund (Enterprise Fund) or Special Revenue Fund:

Dr. 60-xxx-200-860 Transfer of Funds – Indirect Cost Allocation \$XXX

20-xxx-200-860 Other Use of Funds -Indirect Cost Allocation \$XXX

Cr. 60 or 20-402 Interfund Accounts Payable \$XXX

To establish the payable to the general fund for indirect costs allocated to the food service fund or special revenue fund

Dr. 60 or 20-402 Interfund Accounts Payable \$XXX

Cr. 60 or 20-101 Cash \$XXX

To record the payment of cash from the food service fund (or special revenue fund) to the general fund as a reimbursement for indirect costs recorded in the general fund

Indirect Costs Being Transferred Within a Fund (e.g. from one program (administration) within the general fund to a federal program (SEMI) within the general fund)

The charge of indirect costs from one program in the general fund to SEMI results in the realization of SEMI revenue in the general fund. Because SEMI is not maintained as a separate program within the general fund, there is not a requirement to record a transfer of indirect costs (source and use) within the general fund. If a transfer is recorded for internal recordkeeping, the entry must be reversed upon preparation of the financial statements.

Common Indirect Cost Rate Audit Findings

- Approval of a grant that includes indirect costs although an indirect cost application was not approved by the Department of Education
- Inclusion of indirect costs at the awarded rate which exceeds the maximum allowable rate stated in the grant documents (award notification)
- Failure to adjust the direct cost base for subcontracts (See explanation above - 1st year of the grant \$25,000 maximum, subsequent years \$0 is permitted)
- Use of the unrestricted rate when a grant specifies “supplement not supplant”
- The school district did not reduce the direct cost base for vendor refunds/discounts received

Financial Statement Presentation

It is not appropriate to classify indirect costs as expenditures. Indirect costs are simply a transfer of resources, and as such are classified and reported as an “other financing use/source” of funds in the governmental funds statements and as a transfer in statements other than governmental funds statements. Accordingly, for financial statement purposes:

10-5XXX (Line 700 - general fund) and 20-xxx-200-860 (special revenue fund) – Indirect Cost Allocations in governmental fund types (e.g. transfers of cash from a federal award or grant maintained in the special revenue fund to the general fund to reimburse the general fund for indirect costs paid by the general fund and subsequently allocated to the special revenue fund) are reported as an “other financing source of funds” in the general fund and as an “other financing use of funds” in the special revenue fund. (GASBS 34, paragraph 88)

10-5XXX (Line 700- general fund) and 60-xxx-200-860 (enterprise fund) - The transfer of cash from the nonprofit food service fund to the general fund to reimburse the general fund for the allocation of indirect costs paid by the general fund is reported as an “other financing source of funds” in the general fund and as a transfer in the nonprofit food services fund. (GASBS 34, paragraph 88)