Chapter 10 Indirect Costs

1. Are indirect costs requested?

2. Is a copy of the current approved rate from the cognizant agency included?

3. Is the correct rate being used? (If a lower rate than is authorized in the indirect cost rate agreement is being proposed you must explain why your organization is deviating from the approved rate.)

4. Is the rate applied to the correct base? "

5. Are charges which duplicate direct costs excluded? (If no, explain/revise.)

The key for Grant Specialists to focus on is the negotiated indirect rate agreement (NICRA). As long as the organization is using the NICRA rate and applying the appropriate base of application, then whatever the rate, there is no need to justify the costs.

For example, the NICRA has a rate of 50% with a base of application of direct salaries and fringe benefits. If the proposal was for $1,000,000, $400,000 salaries, $100,000 fringe, and $500,000 other direct costs, then the indirect cost should be $250,000.
Grant Specialists shall review items, one thru five which should be addressed in the cost analysis memo. If the organization does not have a negotiated indirect cost rate, then the Grants Specialist shall document what basis was used to determine that the indirect costs are reasonable.

What is a negotiated indirect cost rate agreement?
Indirect cost rates are established by negotiations between the appropriate cognizant federal agency and the applicant organization, based upon an indirect cost rate proposal submitted by the organization. The indirect cost rate agreement, sometimes called NICRA, is the prime document for obtaining indirect cost rate information.

What are fixed indirect rates?
Fixed indirect cost rates are established for a future period based on estimates of costs for that period, but unlike predetermined rates, they are subject to adjustments using a "carry forward" method. Although there is no adjustment of the rate for the current year, the difference between the estimated rate and the actual rate is carried forward in establishing the rate for a subsequent period.

What are predetermined rates?
Predetermined indirect cost rates are established for a future period on an estimate of costs for that period. Except under very unusual circumstances, this type of rate
is not subject to subsequent adjustments. It is used only where cost experience is such that the actual indirect cost can be accurately predicted.

What are provisional rates?

Provisional indirect cost rates are temporarily established to allow reimbursement of indirect costs pending the establishment of a final rate.

What are final rates?

When the final indirect cost rate is established, the provisional rate is adjusted up or down. If the recipient/grantee final rate is less than the provisional rate, they will be required to refund the difference to the US Government.

What is an effective period?

An effective period usually covers different years and usually match the fiscal year or calendar year for an organization. A typical effective period would be from "10/1/06 to 9/30/07". You might also see the term "effective until amended".

What is a basis for application?

The basis or base of application might be "total modified direct costs" or "direct salaries and fringe benefits". The basis for application identifies what costs are to be
used to determine the indirect costs. If the organizations indirect rate is 30% on total modified direct costs then the 30% should be multiplied by the total modified direct costs to determine the indirect cost charges.

**What are modified total direct costs?**

Modified total direct costs are total direct costs minus items excluded from indirect costs. For example, subaward costs over $25,000 would be excluded from the indirect costs rate. Sometimes tuition, equipment, travel costs might be excluded. A review of the negotiated cost rate agreement would state what is excluded.

**What does OMB Circular A-21 say about indirect costs?**

G. Determination and application of F&A cost rate or rates.

1. F&A cost pools.

(1) Subject to subsection b, the separate categories of F&A costs allocated to each major function of the institution as prescribed in Section F shall be aggregated and treated as a common pool for that function. The amount in each pool shall be divided by the distribution base described in subsection 2 to arrive at a single F&A cost rate for each function.

(2) The rate for each function is used to distribute F&A costs to individual sponsored agreements of that function. Since a common pool is established for each major
function of the institution, a separate F&A cost rate would be established for each of the major functions described in Section B.1 under which sponsored agreements are carried out.

(3) Each institution's F&A cost rate process must be appropriately designed to ensure that Federal sponsors do not in any way subsidize the F&A costs of other sponsors, specifically activities sponsored by industry and foreign governments. Accordingly, each allocation method used to identify and allocate the F&A cost pools, as described in Sections E.2 and F.2 through F.9, must contain the full amount of the institution's modified total costs or other appropriate units of measurement used to make the computations. In addition, the final rate distribution base (as defined in subsection 2) for each major function (organized research, instruction, etc., as described in Section B.1) shall contain all the programs or activities that utilize the F&A costs allocated to that major function. At the time a F&A cost proposal is submitted to a cognizant Federal agency, each institution must describe the process it uses to ensure that Federal funds are not used to subsidize industry and foreign government funded programs.

In some instances a single rate basis for use across the board on all work within a major function at an institution may not be appropriate. A single rate for research,
for example, might not take into account those different
environmental factors and other conditions which may affect
substantially the F&A costs applicable to a particular segment
of research at the institution. A particular segment of research
may be that performed under a single sponsored agreement or it
may consist of research under a group of sponsored agreements
performed in a common
environment. The environmental factors are not limited to the
physical location of the work. Other important factors are the
level of the administrative support required, the nature of the
facilities or other resources employed, the scientific
disciplines or technical skills involved, the organizational
arrangements used, or any combination thereof. Where a
particular segment of a sponsored agreement is performed
within an environment which appears to generate a significantly
different level of F&A costs, provisions should be made for a
separate F&A cost pool applicable to such work. The separate F&A
cost pool should be developed during the regular course of the
rate determination process and the separate F&A cost rate
resulting there from should be utilized; provided it is
determined that (1) such F&A cost rate differs significantly
from that which would have been obtained under subsection a, and
(2) the volume of work to which such rate would apply is
material in relation to other sponsored agreements at the
institution.
2. The distribution basis. F&A costs shall be distributed to applicable sponsored agreements and other benefiting activities within each major function (see Section 8.1) on the basis of modified total direct costs, consisting of all salaries and wages, fringe benefits, materials and supplies, services, travel, and subgrants and subcontracts up to the first $25,000 of each subgrant or subcontract (regardless of the period covered by the subgrant or subcontract). Equipment, capital expenditures, charges for patient care and tuition remission, rental costs, scholarships, and fellowships as well as the portion of each subgrant and subcontract in excess of $25,000 shall be excluded from modified total direct costs. Other items may only be excluded where necessary to avoid a serious inequity in the distribution of F&A costs. For this purpose, a F&A cost rate should be determined for each of the separate F&A cost pools developed pursuant to subsection 1. The rate in each case should be stated as the percentage that the amount of the particular F&A cost pool is of the modified total direct costs identified with such pool.

3. Negotiated lump sum for F&A costs. A negotiated fixed amount in lieu of F&A costs may be appropriate for self contained, off campus, or primarily subcontracted activities where the benefits derived from an institution's F&A services cannot be readily determined. Such negotiated F&A costs
will be treated as an offset before allocation to instruction, organized research, other sponsored activities, and other institutional activities. The base on which such remaining expenses are allocated should be appropriately adjusted.

4. Predetermined rates for F&A costs. Public Law 87 638 (76 Stat. 437) authorizes the use of predetermined rates in determining the "indirect costs" (F&A costs in this Circular) applicable under research agreements with educational institutions. The stated objectives of the law are to simplify the administration of cost type research and development contracts (including grants) with educational institutions, to facilitate the preparation of their budgets, and to permit more expeditious closeout of such contracts when the work is completed. In view of the potential advantages offered by this procedure, negotiation of predetermined rates for F&A costs for a period of two to four years should be the norm in those situations where the cost experience and other pertinent facts available are deemed sufficient to enable the parties involved to reach an informed judgment as to the probable level of F&A cost during the ensuing accounting periods.

5. Negotiated fixed rates and carry forward provisions. When a fixed rate is negotiated in advance for a fiscal year (or other time period), the over or under recovery for that year may be included as an adjustment to the F&A cost for the next rate negotiation. When the rate is negotiated before the carry
forward adjustment is determined, the carry forward amount may be applied to the next subsequent rate negotiation. When such adjustments are to be made, each fixed rate negotiated in advance for a given period will be computed by applying the expected F&A costs allocable to sponsored agreements for the forecast period plus or minus the carry forward adjustment (over or under recovery) from the prior period, to the forecast distribution base. Un-recovered amounts under lump sum agreements or cost sharing provisions of prior years shall be carried forward for consideration in the new rate negotiation. There must, however, be an advance understanding in each case between the institution and the cognizant Federal agency as to whether these differences will be considered in the rate negotiation rather than making the determination after the differences are known. Further, institutions electing to use this carry forward provision may not subsequently change without prior approval of the cognizant Federal agency. In the event that an institution returns to a post-determined rate, any over or under recovery during the period in which negotiated fixed rates and carry forward provisions were followed will be included in the subsequent post-determined rates. Where multiple rates are used, the same procedure will be applicable for determining each rate.

6. Provisional and final rates for F&A costs. Where the cognizant agency determines that cost experience and other
pertinent facts do not justify the use of predetermined rates, or a fixed rate with a carry forward, or if the parties cannot agree on an equitable rate, a provisional rate shall be established. To prevent substantial overpayment or underpayment, the provisional rate may be adjusted by the cognizant agency during the institution's fiscal year. Predetermined or fixed rates may replace provisional rates at any time prior to the close of the institution's fiscal year. If a provisional rate is not replaced by a predetermined or fixed rate prior to the end of the institution's fiscal year, a final rate will be established and upward or downward adjustments will be made based on the actual allowable costs incurred for the period involved.

7. Fixed rates for the life of the sponsored agreement.
Federal agencies shall use the negotiated rates for F&A costs in effect at the time of the initial award throughout the life of the sponsored agreement. "Life" for the purpose of this subsection means each competitive segment of a project. A competitive segment is a period of years approved by the Federal funding agency at the time of the award. If negotiated rate agreements do not extend through the life of the sponsored agreement at the time of the initial award, then the negotiated rate for the last year of the sponsored agreement shall be extended through the end of the life of the sponsored agreement. Award levels for sponsored agreements may not be
adjusted in future years as a result of changes in negotiated rates.

When an educational institution does not have a negotiated rate with the Federal Government at the time of the award (because the educational institution is a new grantee or the parties cannot reach agreement on a rate), the provisional rate used at the time of the award shall be adjusted once a rate is negotiated and approved by the cognizant agency.

8. Limitation on reimbursement of administrative costs. Notwithstanding the provisions of subsection 1.a, the administrative costs charged to sponsored agreements awarded or amended (including continuation and renewal awards) with effective dates beginning on or after the start of the institution's first fiscal year which begins on or after October 1, 1991, shall be limited to 26% of modified total direct costs (as defined in subsection 2) for the total of General Administration and General Expenses, Departmental Administration, Sponsored Projects Administration, and Student Administration and Services (including their allocable share of depreciation and/or use allowances, interest costs, operation and maintenance expenses, and fringe benefits costs, as provided by Sections F.5, F.6, F.7 and F.9) and all other types of expenditures not listed specifically under one of the subcategories of facilities in Section F.
Existing F&A cost rates that affect institutions' fiscal years which begin on or after October 1, 1991, shall be unilaterally amended by the cognizant Federal agency to reflect the cost limitation in subsection a. Permanent rates established prior to this revision that have been amended in accordance with subsection b may be renegotiated. However, no such renegotiated rate may exceed the rate which would have been in effect if the agreement had remained in effect; nor may the administrative portion of any renegotiated rate exceed the limitation in subsection a.

Institutions should not change their accounting or cost allocation methods which were in effect on May 1, 1991, if the effect is to: (i) change the charging of a particular type of cost from F&A to direct, or (ii) reclassify costs, or increase allocations, from the administrative pools identified in subsection to the other F&A cost pools or fringe benefits. Cognizant Federal agencies are authorized to permit changes where an institution's charging practices are at variance with acceptable practices followed by a substantial majority of other institutions.

What does OMB Circular A-87 say about indirect costs?

F. Indirect Costs
1. General. Indirect costs are those: (a) incurred for a common or joint purpose benefiting more than one cost objective, and (b) not readily assignable to the cost objectives specifically benefited, without effort disproportionate to the results achieved. The term "indirect costs," as used herein, applies to costs of this type originating in the grantee department, as well as those incurred by other departments in supplying goods, services, and facilities. To facilitate equitable distribution of indirect expenses to the cost objectives served, it may be necessary to establish a number of pools of indirect costs within a governmental unit department or in other agencies providing services to a governmental unit department. Indirect cost pools should be distributed to benefited cost objectives on bases that will produce an equitable result in consideration of relative benefits derived.

2. Cost allocation plans and indirect cost proposals. Requirements for development and submission of cost allocation plans and indirect cost rate proposals are contained in Attachments C, D, and E.

3. Limitation on indirect or administrative costs. In addition to restrictions contained in this Circular, there may be laws that further limit the amount of administrative or indirect cost allowed. Amounts not recoverable as indirect costs or administrative costs under one Federal award may not be
shifted to another Federal award, unless specifically authorized by Federal legislation or regulation.

**What does OMB Circular A-122 say about indirect costs?**

**C. Indirect Costs**

1. Indirect costs are those that have been incurred for common or joint objectives and cannot be readily identified with a particular final cost objective. Direct cost of minor amounts may be treated as indirect costs under the conditions described in subparagraph B.2. After direct costs have been determined and assigned directly to awards or other work as appropriate, indirect costs are those remaining to be allocated to benefiting cost objectives. A cost may not be allocated to an award as an indirect cost if any other cost incurred for the same purpose, in like circumstances, has been assigned to an award as a direct cost.

2. Because of the diverse characteristics and accounting practices of non-profit organizations, it is not possible to specify the types of cost which may be classified as indirect cost in all situations. However, typical examples of indirect cost for many non-profit organizations may include depreciation or use allowances on buildings and equipment, the costs of operating and maintaining facilities, and general administration and general expenses, such as the salaries and expenses of executive
officers, personnel administration, and accounting.

3. Indirect costs shall be classified within two broad categories: "Facilities" and "Administration." "Facilities" is defined as depreciation and use allowances on buildings, equipment and capital improvement, interest on debt associated with certain buildings, equipment and capital improvements, and operations and maintenance expenses. "Administration" is defined as general administration and general expenses such as the director's office, accounting, personnel, library expenses and all other types of expenditures not listed specifically under one of the subcategories of "Facilities" (including cross allocations from other pools, where applicable). See indirect cost rate reporting requirements in subparagraphs D.2.e and D.3.g.