

Indirect Cost Rate Proposal

Guidance Handbook for School Districts

Table of Contents

Introduction	1
Purpose of Indirect Cost Rates	1
Timeframe.....	1
Types of Indirect Cost Rates	2
Restricted Rates	2
Unrestricted Rates.....	2
Actual Costs.....	2
Classification of Costs.....	3
Excluded Costs	3
Unallowable Costs.....	3
Direct Costs.....	4
Indirect Costs	4
Calculation of Indirect Cost Rates	4
Completing the Indirect Cost Rate Proposal.....	5
Functionality of Cells	5
Certification Tab	5
U-1 Tab (Unrestricted Rate)	6
How to Complete the U-1 Tab.....	6
Specific Issues	6
Restricted Rate Adjustment Tab	8
Completing the Top Section	8
Completing the Middle Section.....	9
Completing the Bottom Section.....	9
R-1 Tab (Restricted Rate).....	9
Subrecipient Items Tab.....	10
Completing Section II	10
Completing Section II (Alternative Method)	10
Excluded Costs Tab	11
Organizational Chart Requirement Tab	11
Submitting the Completed ICRP to TEA	12
APPENDIX I: Classification of Costs	13
Excluded Costs	13
Capital Outlay	13
Subrecipient Items	13
Debt	13
Food Service Programs (Food Purchases Only)	14
Other Distorting Items	14
Unallowable Costs.....	14

Direct Costs.....	14
Indirect Costs	15
APPENDIX II: Subrecipient Items	16
Service Providers	16
APPENDIX III: Function Codes	18
APPENDIX IV: Object Codes	25
APPENDIX V: Relevant Federal Statutes	28
Restricted Rate Formula.....	28
General Management Costs.....	28
Fixed Costs	29
Other Expenditures.....	29
Occupancy and Space Maintenance Costs	29
Cost Allocations for State and Local Government, USDE	30
OMB A-87, Attachment A—General Principles for Determining Allowable Costs.....	30
C. Basic Guidelines.....	30
D. Composition of Cost	30
E. Direct Costs.....	31
F. Indirect Costs.....	31
OMB A-87, Attachment B	31
1. Advertising and public relations costs	31
2. Advisory councils	32
3. Alcoholic beverages	32
4. Audit costs and related services.....	32
5. Bad debts.....	33
6. Bonding costs	33
7. Communication costs.....	33
8. Compensation for personal services	33
9. Contingency provisions	37
10. Defense and prosecution of criminal and civil proceedings, and claims.....	37
11. Depreciation and use allowances	37
12. Donations and contributions.....	39
13. Employee morale, health, and welfare costs	39
14. Entertainment.....	40
15. Equipment and other capital expenditures	40
16. Fines and penalties	41
17. Fund raising and investment management costs	41
18. Gains and losses	41
19. General government expenses	42
20. Goods or services for personal use.....	42

21. Idle facilities and idle capacity	42
22. Insurance and indemnification.....	43
23. Interest.....	44
24. Lobbying	45
25. Maintenance, operations, and repairs	45
26. Materials and supplies costs	45
27. Meetings and conferences	46
28. Memberships, subscriptions, and professional activity costs	46
29. Patent costs	46
30. Plant and homeland security costs.....	46
31. Pre award costs	46
32. Professional service costs.....	47
33. Proposal costs	47
34. Publication and printing costs.....	47
35. Rearrangement and alteration costs	48
36. Reconversion costs.....	48
37. Rental costs of buildings and equipment.....	48
38. Royalties and other costs for the use of patents.....	48
39. Selling and marketing.....	49
40. Taxes	49
41. Termination costs applicable to sponsored agreements.....	49
42. Training costs.....	51
43. Travel costs.....	51
OMB Circular A-133	52
§____.210 Subrecipient and vendor determinations.	52
USDA: Indirect Cost Guide	53
Appendix 1, Step 2: Remove All Excluded Costs	53

Introduction

The purpose of this handbook is to give your school district specific instructions on how to prepare and submit an Indirect Cost Rate Proposal (ICRP) to TEA. The handbook also provides general information about the purpose of indirect cost rates.

The ICRP is an Excel form. Effective September 1, 2014, all Texas school districts must complete and submit an ICRP to request a federal indirect cost rate from TEA. The requirements of the ICRP are based upon federal requirements given in the following:

- Education Department General Administrative Regulations (EDGAR), Parts 76.560 through 76.568
- Office of Management and Budget (OMB) cost principles (OMB Circular A-87)
- US Department of Education (USDE) Cost Allocation Guide for State and Local Governments
- USDE's approved indirect cost delegation agreement with TEA

The delegation agreement with USDE designates TEA as a cognizant agency and authorizes TEA to issue indirect cost rates to school districts and other local educational agencies. Other federal agencies recognize the federal indirect cost rate issued by TEA.

The US Council on Financial Assistance Reform (COFAR) is currently revising and consolidating several federal circulars that provide the basic rules and regulations for the administration of federal education grants. The resulting Uniform Grants Guidance will go into effect December 26, 2014. OMB Circular A-87 is among the circulars that will be replaced, and the requirements related to indirect cost rates and the ICRP may change. TEA will update this handbook as necessary.

Purpose of Indirect Cost Rates

School districts use indirect cost rates to recover their district-wide administrative costs of managing federal grants, such as costs related to accounting, budgeting, purchasing, auditing, and payroll processing. TEA allows school districts to use indirect cost rates to recover the district-wide administrative costs of managing state grants as well.

With an approved indirect cost rate issued by TEA, you can transfer a certain percentage of funds from each applicable grant to your district's general fund as compensation for the administrative costs incurred by managing the grant. Once transferred to the general fund, these grant funds do not need to be tracked in any way.

Timeframe

Your district must request a new indirect cost rate from TEA by submitting an ICRP in February of each year. The agency reviews the ICRPs through February, March, and April, and may contact you to clarify certain issues. This negotiation may require you to fix discrepancies and resubmit the ICRP, and may result in changes to your indirect cost rate.

TEA publishes the indirect cost rate for every school district in May of each year. The indirect cost rate is effective from July 1 of the year in which it is issued, through June 30 of the following year.

Types of Indirect Cost Rates

There are two types of indirect cost rates, and you must understand the difference between them so that you can use the appropriate type for each of your district's federal and state grants. TEA issues you both types of rates when you submit an ICRP.

Restricted Rates

Restricted rates must be used for those of your federal and state grants that are subject to the supplement, not supplant requirement. The supplement, not supplant requirement means that grant funds must only be used to *enhance* existing state or local funds or activities, and must not be used to *replace* state or local funds or activities. Most of the federal and state grants awarded by TEA are subject to this requirement, including, but not limited to, the following:

- Title I, Part A Programs: Local Education Agencies
- Migrant Education: Basic State Formula Grant Program

To determine if any of the grants awarded to your school district by TEA are subject to this requirement, please check the *Program Guidelines* for each grant. To determine if any of the federal grants awarded by another agency are subject to this requirement, please check with the awarding agency. In general, all state grants are subject to the requirement.

You must also be aware of other restrictions, such as limits on administrative costs, that may apply to certain federal grant funds. These restrictions may limit the amount of indirect cost revenue that your district can claim. To determine if any of the federal grants awarded to your school district by TEA are subject to other restrictions, please check the *Program Guidelines* for each grant. To determine if any of the federal grants awarded by another agency are subject to other restrictions, please check with the awarding agency.

Unrestricted Rates

Unrestricted rates must be used for those of your federal and state grants that are *not* subject to the federal supplement, not supplant requirement. Some of the federal grants that are not subject to the supplement, not supplant requirement include, but are not limited to, the following:

- Child Nutrition Program
- School Health and Related Services

To determine which of the federal and state grants awarded to your school district by TEA are subject to this requirement, please check the *Program Guidelines* for each grant. To determine if any of the federal grants awarded by another agency are subject to this requirement, please check with the awarding agency. In general, all state grants are subject to the requirement.

Actual Costs

TEA uses each district's *actual* costs for a fiscal year to calculate indirect cost rates, using specific formulas based upon the kinds of costs that are allowable under federal guidelines. You provide TEA with your district's actual costs by submitting the information on the ICRP.

The information you enter on the ICRP must come directly from the annual financial and compliance report (AFR) that your district submitted to TEA for the previous fiscal year. For example, when completing the ICRP to request an indirect cost rate for school year 2015–2016, you must use information from your district's AFR for fiscal year 2014 (school year 2013–2014).

To complete the ICRP, you will need three sections of your district's AFR: the Statement of Revenues, Expenditures, and Changes in Fund Balances—Governmental Funds, the Statement of Revenues, Expenditures, and Changes in Fund Net Position—Proprietary Funds, and the capital asset section of the Notes to the Financial Statements. You will also need the financial reports used by your independent auditor to prepare these sections of the AFR.

One section of the ICRP asks for actual costs identified by object code. Your district's AFR does not provide that level of detail, so you will have to prepare other financial reports that identify costs by object code and separate the totals listed in the AFR into specific cost items. For more information about object codes, please consult Module 1, Financial Accounting and Reporting, of TEA's [Financial Accountability System Resource Guide \(FASRG\)](#). Please note that TEA is currently revising Module 1. This may result in changes to account coding rules. TEA will update this handbook as necessary.

Classification of Costs

In order for you to understand how TEA calculates indirect cost rates, and to ensure that you complete the ICRP correctly, it is important to understand how actual costs must be classified into categories. Federal guidelines stipulate that all of your district's actual costs must be classified into one of the four categories described below. Please note that you must classify each cost into only one category, and that your district must be consistent when classifying costs. For example, if you classify an item as a direct cost, a similar item used for the same purpose in another functional area must also be classified as a direct cost.

More detailed information about each category is available in Appendix I of this document.

Excluded Costs

Excluded costs are those costs that are extraordinary and/or distorting. They cannot be used in TEA's indirect cost rate calculation. Examples of excluded costs include, but are not limited to:

- Capital outlay (such as capitalized land, buildings, and improvements)
- Items in a capital project fund
- All debts (inside or outside a debt service fund)
- Subawards to other entities (if over \$25,000 per year)
- Payments to fiscal agents and member districts of shared service arrangements
- Pass-through funds to other governmental entities

Unallowable Costs

Unallowable costs are those costs designated by OMB cost principles as unallowable. These costs are related to items that cannot be paid for with federal grant funds. TEA uses unallowable costs to calculate your district's indirect cost rate. Examples of unallowable costs include, but are not limited to:

- Bad debts (Bad debts are funds owed to your district, which your district is responsible for paying to another entity, such as money owed by students for school lunches, which your district must pay to a food service entity. Any related legal and collection costs are also unallowable.)
- Contingencies (funds set aside for possible future expenses, such as lawsuit settlements or refunds to TEA)
- Entertainment costs
- Fines and penalties

- Contributions and donations to outside organizations
- Governance (expenditures incurred by providing support to the school board and expenditures related to the collection of property tax)

Direct Costs

Direct costs are those costs related to a specific cost objective, that focus on one grant program, organization, subject, or phase of an operation. TEA uses direct costs to calculate your district's indirect cost rate. Examples of direct costs include, but are not limited to:

- Compensation of the employees who work on the program
- Supplies and materials for the program
- Equipment purchased and used for the program
- Travel expenses incurred to carry out the program

Indirect Costs

Indirect costs are those costs related to more than one cost objective that cannot easily be associated with a specific cost objective. TEA uses indirect costs to calculate your district's indirect cost rate. Only the following two items can be classified as indirect costs:

- General management costs, which are those costs related to the direction and control of a district's district-wide function, such as payroll, human resources, and accounting costs. They include the salaries for and expenses related to employees who perform these activities.
- Fixed costs related to general management costs, such as retirement, unemployment compensation, and health insurance costs, and contributions to fringe benefits.

Calculation of Indirect Cost Rates

TEA uses your classification of actual costs to calculate your district's indirect cost rate. The calculation is based upon a simple ratio of your district's indirect costs to direct costs. The numerator in this ratio is your district's indirect cost pool. The indirect cost pool is the total of all of your district's indirect costs. The denominator is your district's modified total direct cost (MTDC) pool. The MTDC pool is the total of all of your district's direct costs and unallowable costs. TEA includes some specific indirect costs in the numerator to calculate the unrestricted indirect cost rate, and then moves them to the denominator to calculate the restricted indirect cost rate. These specific indirect costs are related to certain district employees, such as the superintendent.

Dividing the numerator by the denominator results in a preliminary indirect cost rate:

$$\text{indirect cost pool} \div \text{MTDC pool} = \text{preliminary indirect cost rate}$$

$$\text{Example: } \$120,000 \div \$2,000,000 = 6\%$$

TEA then applies a five percent discounting factor to calculate the final indirect cost rate. This discounting factor is applied because the financial data used in the calculation is two years old. The discounting factor is intended to account for fluctuations in a district's financial data over those two years, and mitigate the possibility that a district may receive an indirect cost rate that is too high. TEA's discounting factor has been approved by USDE.

Applying the discounting factor to the preliminary indirect cost rate results in the final indirect cost rate:

$$\text{preliminary indirect cost rate} \times \text{discounting factor} = \text{final indirect cost rate}$$

$$\text{Example: } 6\% \times 95\% (.95) = 5.7\%$$





Completing the Indirect Cost Rate Proposal

The ICRP is an Excel form with seven tabs. The following are step-by-step instructions for completing the form. When you have finished completing the form, you must submit the form and the required attachments by uploading them through TEA's GFFC Reports and Data Collections secure application in [TEA's secure environment, TEASE](#). Specific instructions about how to upload documents are given at the end of this document.

Be sure to save your work often. Also note that when you save the name of your school district on the first tab, the form will automatically populate your district's name on each tab.

Functionality of Cells

Throughout the ICRP, specific cells have different functions. The table below describes the function of each type of cell.

Type of Cell	Function
	Clear cells allow data entry.
	Patterned cells allow data entry, but the amounts you enter are subject to review and negotiation with TEA.
	Dark cells do not allow data entry because those costs are not allowed in that column.
	Highlighted cells (without a pattern) do not allow data entry. These cells perform a calculation, are automatically populated with data from another cell, or are simply blank.

Certification Tab

The first tab of the ICRP is your district's certification of the information submitted on the form. The certification must be signed by the district's superintendent, chief executive officer (CEO), or chief financial officer (CFO). To complete the certification:

1. Enter the name of your school district.
2. Enter the name of the district official who is signing the form.
3. Select the official's title from the pulldown menu.
4. Print the certification tab.
5. Have the superintendent, CEO, or CFO sign and date the printed page.
6. Scan the signed and dated page.
7. Upload the scanned certification with your ICRP (specific instructions are given later in this document)

U-1 Tab (Unrestricted Rate)

The second tab of the ICRP, called the U-1 tab, is where you classify your district's actual costs. For each row, you must enter the amounts into one of the columns to classify costs into either excluded, unallowable, direct, or indirect costs. You cannot classify costs into more than one category. Once you have entered all of the required data, the tab will calculate your district's unrestricted indirect cost rate.

How to Complete the U-1 Tab

The rows in this tab are divided into sections that correspond to function codes, also called data control codes. Each section contains specific cost items. The section for function code 41 (general administration) contains cost items identified by object code.

You can complete the tab by filling in amounts row by row or column by column, so long as you classify each cost into excluded, unallowable, direct, or indirect costs.

Please refer to the definitions given above for each type of cost. Appendix I of this document gives more detailed information that can also help you classify costs. The federal regulations about unallowable costs given in OMB A-87, Attachment B, Selected Items of Cost, can be found in Appendix V of this document.

Specific Issues

Certain rows and columns require particular attention.

Governance costs. You must classify most costs related to the governance of your district as unallowable costs. These costs include expenditures your district incurred by providing support to the school board, as well as expenditures related to your district's collection of property tax (for example, a fee your district paid to a third party to collect property taxes on your behalf). These expenditures are usually identified in school district records with organization codes 702 (school board) and 703 (tax office). Some governance costs, however, may be related to other kinds of expenditures, and you must classify these accordingly. For example, any related capital outlay costs your district incurred, such as the cost of constructing a new meeting room for the school board, must be classified as excluded costs.

Indirect costs. The U-1 tab separates indirect costs into two columns. One column is for restricted indirect costs, and one column is for all other indirect costs. Restricted indirect costs are those costs related to specific employees within your district. In this column, using rows in the section for function codes 21, 23, 41, 51, 52, and 53, as appropriate, enter the salaries and fixed costs for the following employees only:

- The superintendent
- All employees who are members of the superintendent's immediate office support staff (such as the executive or administrative assistant)
- All employees who act as chief executive officers (CEOs), regardless of their actual titles, of any component of the district. A component is an organizational unit that benefits the entire district. On a district's organizational chart, CEOs are generally one level below the superintendent, although in large districts, CEOs may be two levels below the superintendent. They generally hold job titles such as assistant superintendent, deputy superintendent, chief financial officer, and human resource director.

- All employees who are members of a CEO's immediate office support staff (such as executive or administrative assistants).

Fixed costs for these employees are the costs paid by your district for fringe benefits and similar costs associated with employment, including the following:

- Employee retirement matching
- Federal Insurance Contributions Act (FICA) matching
- Pension fund payments
- Premium expenditures for health insurance and liability insurance
- Unemployment compensation
- Unused leave (for separating employees)

Please note that your school district must submit a district organizational chart as part of the ICRP. TEA will use the organizational chart to review and verify positions you include in the restricted indirect cost rate column.

Separating the indirect costs into two columns demonstrates how some indirect costs are used differently when TEA calculates indirect cost rates. To calculate an *unrestricted* indirect cost rate, TEA includes the restricted indirect costs in the numerator of the ratio. To calculate a *restricted* indirect cost rate, TEA moves the restricted indirect costs to the denominator of the ratio.

Food service enterprise fund. The student services section contains a row for the food service enterprise fund, which is not applicable to all school districts. Your district has this cost if you identify your food service operations in your accounting records as a business type of function with fund number 701. You must classify this cost if it is applicable to your district. If this cost is applicable to your district, the amount can be found in the *Statement of Revenues, Expenditures, and Changes in Fund Net Position—Proprietary Funds* section of your district's AFR (usually the total operating expenses in the child nutrition column).

Occupancy and space maintenance costs. The Support Services (Non–Student Based) section contains three rows for occupancy and space maintenance costs. According to 34 CFR §76.568, “occupancy and space maintenance costs associated with organization-wide service functions (accounting, payroll, personnel) may be considered general management costs,” and must therefore be classified as indirect costs. Occupancy and space maintenance costs include the following costs, which are generally identified by function codes 51, 52, and 53:

- Janitorial services and supplies
- Building, grounds, and parking lot maintenance
- Guard services
- Light, heat, and power
- Other related space costs

Governmental capital asset activity. The last two rows of the U-1 tab provide space for you to enter information about your district's governmental capital assets. You must enter this information in the total costs column. TEA will calculate depreciation costs and add those costs to your district's general management and fixed costs in the indirect costs column.

Most of the information you need can be found in the *Notes to the Financial Statements* section, under “Capital Assets” or “Capital Asset Activity,” in your district’s AFR. You must enter amounts for:

1. The total cost of buildings and improvements *minus* the following:
 - land costs
 - the change in value of buildings over 50 years old
 - the amount of federal funds your district used to pay for buildings
2. Total furniture and equipment *minus* the following:
 - the change in value of furniture and equipment over 16 years old
 - the amount of federal funds your district used to pay for furniture and equipment

Restricted Rate Adjustment Tab

The third tab of the ICRP is where you enter square footage information about your district’s space and details about certain indirect costs you entered on the U-1 tab. Once you have entered all of the required data, the ICRP will be able to calculate your district’s restricted indirect cost rate.

The tab demonstrates how the restricted indirect cost rate is calculated by moving a portion of your district’s indirect costs from the indirect cost pool to the modified total direct cost pool and subtracting a portion of the facilities costs and capital asset changes.

The tab is divided into three sections. The top section is where you enter the square footage used for district-wide activities. The middle section performs a calculation and does not require you to enter any data. The bottom section is where you enter position details for the employees for whom you entered square footage information in the top section.

Completing the Top Section

The top section is required, even if you did not enter any occupancy and space maintenance costs on the U-1 tab. Enter the following amounts related to your district’s physical space:

1. The total square footage used for district-wide activities, including the square footage for common areas and idle spaces. Examples of district-wide organizational activities include administration and maintenance. You must also include the square footage of specific spaces on individual school campuses where district-wide activities take place. For example, if a high school campus houses a technology department that is used by the entire district, the square footage of the technology department can be included.
2. Of the total square footage, the square footage of common areas only. Common areas include space used by all district employees, such as bathrooms, hallways, and break rooms.
3. Of the total square footage, the square footage of idle space. Idle space is space not currently used by the school district, such as an unoccupied floor or building.
4. Of the total square footage, the square footage of the space occupied by the superintendent, all employees that act as CEOs of any component of the district, and all employees who are members of their immediate office support staff. These are the same employees for whom you entered salaries and fixed costs in the restricted indirect costs column of the U-1 tab.

The tab subtracts the square footage of common areas and idle spaces from the total to get a modified total square footage for your district, and uses this number to perform the calculation in the middle section of the tab.

Completing the Middle Section

The middle section of the restricted rate adjustment tab performs a calculation based upon data you entered previously. You cannot enter any data in this section. The tab applies a percentage of your district's modified total square footage to the amounts you entered in the indirect costs column (the rows for function codes 51, 52, and 53) for occupancy and space maintenance costs in the U-1 tab. This calculation determines your district's *associated costs* for occupancy and space maintenance, which are those costs related to the occupancy and space maintenance of the superintendent, all employees that act as CEOs of any component of the district, and all employees who are members of their immediate office support staff. The tab moves the *associated costs* from the indirect cost pool to the modified total direct cost pool.

Completing the Bottom Section

In the bottom section of the tab, enter position details for the employees for whom you entered square footage occupied in the top section (superintendent, all employees that act as CEOs of any component of the district, and all employees who are members of their immediate office support staff). You will find the necessary information on the employee's time and effort record (if the employee is paid with federal funds) or on the employee's job description. For each employee, enter the following:

- Function code
- Position title
- Salary amount
- Fixed costs amount

The tab will calculate totals for the salary and fixed costs amounts, and a grand total for both amounts. The tab will also display the total for these indirect costs that you entered on the U-1 tab. *Please make sure that these totals are exactly the same.* If they are not the same, the tab will highlight the total in red. You must make adjustments to the amounts you entered on this tab, or on the U-1 tab, until the totals are the same. *Please do not submit the ICRP with a total highlighted in red. If you do, TEA will contact you to clarify your amounts.*

Please note that you will be asked to submit an organizational chart for your district on the last tab of the ICRP. TEA will review the organizational chart and verify that it supports the position details you enter on the restricted rate adjustment tab.

R-1 Tab (Restricted Rate)

The fourth tab of the ICRP calculates your district's restricted indirect cost rate. The ICRP populates this tab from data you entered previously on the U-1 and restricted rate adjustment tabs. *You do not need to enter any data on this tab.*

The R-1 tab removes the restricted indirect costs from the indirect cost pool and places these costs in the modified total direct cost pool.

You should verify that the R-1 tab is able to calculate a restricted indirect cost rate. Please make sure that the Support Services (Non-Student Based) section displays totals in the rows for functions 51, 52, and 53. If totals are not displayed, the tab is unable to calculate your district's

restricted indirect cost rate. If this happens, you must review the U-1 and restricted rate adjustment tabs and make sure you enter data in each cell that requires it. Once you have entered any missing data, the R-1 tab will be able to make the calculation.

Subrecipient Items Tab

The fifth tab of the ICRP is the subrecipient items tab. This is where you enter the amount of your district's subrecipient items. Subrecipients items are funds distributed by your district to another entity related to:

- Subawards, subgrants, and subcontracts
- Payments to fiscal agents and member districts of shared services arrangements
- Other pass-through funds (funds given to other governmental entities that are not fiscal agents or member districts of shared services arrangements)

If your district *does not* have any subrecipient items, you can simply check the box in Section I to assure that your district does not have any subrecipient items. If your district *does* have subrecipient items, you must skip Section I and enter all of the required information in Section II.

Subrecipient items need to be accounted for separately so that TEA can calculate an accurate indirect cost rate for your district. Because your district distributed the funds to other entities, your district did not incur the administrative costs that would normally be associated with using the funds to fulfill the objectives of a program. The amounts entered in the subrecipient items tab provide TEA with an accurate picture of your district's actual expenditures.

Subrecipient items are not the same as procurements. More information about subrecipient items is available in Appendix II.

Completing Section II

In Section II, enter all subrecipient items that are applicable to your district, based upon the three types defined above. For each subrecipient item, you must include the following information:

- The name of the payee
- The payee's federal CFDA number or the state legislative authority
- Begin date of the agreement
- End date of the agreement
- The amount of the payment, according to the following rules:
 - For subawards, subgrants, and subcontracts, you must only enter amounts over the first \$25,000. For example, if a subaward amount is \$100,000, you should not include the first \$25,000 and enter only \$75,000.
 - For payments to fiscal agents and member districts of shared services arrangements, you must enter the full amounts of all payments.
 - For all pass-through funds, you must enter the full amounts of all payments. These payments are often called "transfers," and school districts often identify these payments by function codes 91, 92, 93, 94, 95, 96, 97, and 99.

Completing Section II (Alternative Method)

If you would like to use your district's financial reports to submit the subrecipient item information instead of entering all of the information manually, you may do so. The reports must

be based upon the three types of subrecipient items defined above. Please use the following instructions:

1. Generate a report for each type of subrecipient item. The report must include all of the required information and include a grand total.
2. For each report, add a new tab to the ICRP.
3. Name the new tabs "Subawards," "Payments to," and "Pass-through."
4. Copy the data from each report into the rows and columns of the appropriate new tab.
5. Use Section II of the subrecipient items tab to summarize the information from each report. Using the first three rows, enter the type of each subrecipient item in the payee column and the total amount for the type in the total column.

The tab will calculate a grand total for all subrecipient items, which is used on the next tab.

Excluded Costs Tab

The sixth tab of the ICRP is the excluded cost tab. This is where you separate the excluded costs you entered in the excluded costs column of the U-1 tab into more detailed types of costs. From the totals you entered in the U-1 tab, enter specific costs for the following:

- Subrecipient items (populated from grand total calculated in the subrecipient items tab)
- Capital (such as capitalized land, buildings, and equipment), including
 - Items in a capital project fund (major or nonmajor fund)
 - Capital outlay not included in a capital project fund (66XX)
- Debt (including interest), including
 - Debt service fund (major or nonmajor fund)
 - Debt service not included in debt service fund (65XX)
- Other excluded items, including
 - Texas Retirement System (TRS) on-behalf payments paid by the school district from governmental funds (object code 6144)
 - Medicaid Part D payments paid by the school district from governmental funds (object code 6144)
 - Food and milk costs within the school food service program (object code 6341)
 - Monetary judgments against the district
 - Internal service fund expenditures (only those expenditures identified in your district's AFR as governmental funds)
 - Indirect cost recoveries (only those amounts identified in your district's AFR as governmental funds)
 - Other transfers (other intergovernmental transfers that are not considered subrecipient items)

The tab will calculate a grand total of excluded costs, and will also display the total from the excluded costs column for the row labeled "Total Costs of all Functions" on the U-1 tab. Please make sure that the two totals are exactly the same. If the totals are not the same, the tab will display the difference in red. If this happens, you must review the amounts you entered on the U-1 tab and on the excluded costs tab, and correct any discrepancies until the two totals are exactly the same.

Organizational Chart Requirement Tab

The seventh and final tab of the ICRP describes the organizational chart that your district must submit as part of the ICRP. The tab also shows an example of an appropriate organizational chart.

The organizational chart you submit must reflect the organizational structure that was in place during the same fiscal year as the annual financial and compliance report you use to complete the ICRP. It must also support the positions whose office space, salaries, and fixed costs you entered in the U-1 and restricted rate adjustment tab (the superintendent, all employees who act as CEOs of any component of the district, and all employees who are members of their immediate office support staff).

You must upload your district's organizational chart with your ICRP. Specific instructions are given below.

Submitting the Completed ICRP to TEA

Complete the following steps to submit your district's completed ICRP, certification, and organizational chart to TEA:

1. Log on to the [TEA secure environment, TEASE](#).
2. Select GFFC Reports and Data Collections.
3. Select Upload Response Documents.
4. Select one of the following documents from the pulldown menu:
 - a. ICRP excel workbook
 - b. ICRP certification
 - c. ICRP organizational chart
5. Select the school year for which you are requesting an indirect cost rate. If you are submitting an ICRP in February of 2015, select the 2015–2016 school year.
6. Select Upload Document.
7. Repeat steps 4–6 to upload each of the three required documents.

APPENDIX I: Classification of Costs

This appendix is designed to help you understand how to classify your district's actual costs in the U-1 tab of the ICRP. Each of the four categories of costs are defined in the body of this document, but this appendix provides more detailed examples of each category.

Excluded Costs

Excluded costs are those costs that are extraordinary and/or distorting. They cannot be used in TEA's indirect cost rate calculation because they are related to functions and activities that do not generate administrative costs for your school district the way other functions, such as payroll and accounting, do. Examples of excluded costs include, but are not limited to:

Capital Outlay

Your district must classify the cost of capitalized land, buildings, improvements, and equipment as excluded costs. A school district must classify the following as excluded costs:

- Acquisitions, construction, or major renovation of school district facilities
- Land, buildings, and equipment
- Furniture and equipment meeting capital outlay criteria (a cost of \$5,000 or more per unit, or the cost established by the district, and a useful life of more than one year)

School districts own these assets outright, whether they were purchased or donated. Any costs incurred in acquiring these assets, such as the following, must also be classified as excluded costs:

- Expenditures and expenses for freight and installation
- Other costs necessary to render the item operable

You must classify the cost items associated with the following fund types as excluded costs:

- All items in a capital project fund (whether a major or nonmajor fund)
- Capital outlay items not included in a capital project fund (6600)

Subrecipient Items

Subrecipient items are monetary distributions made by your district to other entities, including

- Subawards, subgrants, and subcontracts
- Payments to fiscal agents and member districts of shared services arrangements
- Other pass-through funds (funds given to other governmental entities that are not fiscal agents or member districts of shared services arrangements)

Debt

The amount of both short-term and long-term debts are excluded costs, including both the principal debt amount and any interest. Your school district must classify all debt, whether inside a debt service fund or outside a debt service fund, as excluded costs.

Debt-related fines and penalties are also excluded costs. Your district probably identifies the applicable debt-related costs as follows:

- Entire debt service fund (whether a major or nonmajor fund)
- Any other debt service (including short-term) not included in debt service fund (6500)

Food Service Programs (Food Purchases Only)

Your school district must classify the cost of food and milk purchased for food service programs as excluded costs. Please note that operating costs for a child nutrition program (food service enterprise fund) must *not* be classified as excluded costs.

Other Distorting Items

You must classify the following items, which can distort your actual costs, as excluded costs:

- TRS on-behalf payments paid by the school district from governmental funds (object code 6144)
- Medicaid Part D payments paid by the school district from governmental funds (object code 6144)
- Monetary judgments against the district
- Internal service fund expenditures (only those expenditures identified in your district's AFR as governmental funds)
- Indirect cost recoveries (only those amounts identified in your district's AFR as governmental funds)
- Other transfers (other intergovernmental transfers that are not considered subrecipient items)

Unallowable Costs

Unallowable costs are those costs designated by OMB cost principles as unallowable. These costs are related to items that cannot be paid for with federal grant funds. Examples of unallowable costs include, but are not limited to:

- Bad debts (Bad debts are funds owed to your district, which your district is responsible for paying to another entity, such as money owed by students for school lunches, which your district must pay to a food service entity. Any related legal and collection costs are also unallowable.)
- Contingencies (funds set aside for possible future expenses, such as lawsuit settlements or refunds to TEA)
- Entertainment
- Fines and penalties
- Contributions and donations to outside organizations
- Governance (expenditures incurred by providing support to the school board and expenditures related to the collection of property tax)

Unallowable costs are associated with a variety of function codes. Your district must carefully review all costs in order to classify them appropriately.

Direct Costs

Direct costs are those costs related to a specific cost objective, that focus on one grant program, organization, subject, or phase of an operation. Salaries and costs related to one identifiable goal are examples of direct costs.

You should classify most of the costs associated with the following function codes as direct costs:

- 10 (instruction and instructional related services)
- 20 (instructional and school leadership)
- 30 (student support services)
- 60 (ancillary services)

Please note, however, that this is not a comprehensive list. There are also other function codes that may be associated with direct costs. These function codes may also be associated with some costs that must be classified as excluded or unallowable costs. Your district must carefully review all costs in order to classify them appropriately.

Indirect Costs

Indirect costs are those costs related to more than one cost objective that cannot easily be associated with a specific cost objective. Indirect costs can only be one of the following two items:

- General management costs, which are those costs related to the direction and control of a district's district-wide function, such as payroll, human resources, and accounting costs. They include the salaries for and expenses related to employees who perform these activities.
- Fixed costs related to general management costs, such as retirement, unemployment compensation, and health insurance costs, and contributions to fringe benefits.

Examples of indirect costs include, but are not limited to:

- Purchasing
- Payroll
- Personnel functions
- Maintenance and operations of district-wide space
- Data processing
- Accounting
- Auditing
- Budgeting
- Communications (such as telephones and postage)

You must classify the majority of costs associated with the following function codes as indirect costs:

- 40 (general administration costs, including salaries and costs for employees that perform accounting, payroll preparation, or personnel administration activities)
- 50 (school district support services costs, including salaries and costs for employees performing district-wide support services)

These function codes may also be associated with some costs that must be classified as excluded, direct, or unallowable costs. Your district must carefully review all costs in order to classify them appropriately.

APPENDIX II: Subrecipient Items

This appendix is designed to help you complete the subrecipient items tab of the ICRP by helping you identify which of your district's monetary distributions to other entities must be included.

You must enter amounts your district distributed that are related to the following:

- Subawards, subgrants, and subcontracts
- Payments to fiscal agents and member districts of shared services arrangements
- Other pass-through funds (funds given to other governmental entities that are not fiscal agents or member districts of shared services arrangements)

Most districts understand payments to fiscal agents and member districts of shared services arrangements and pass-through funds that they transfer to other governmental entities. The distribution of funds in a subaward, subgrant, or subcontracts is less straightforward.

Federal guidance defines a subaward, or a subrecipient item, as generally referring to a monetary award made as a result of a federal award to a school district, *then to a subrecipient or subcontractor*.

Subrecipient items also include subgrants and subcontracts. Some districts may refer to these items as collaboration agreements or consortium agreements

For the ICRP, TEA is only concerned with *major* subawards, and has adopted the accepted definition that a major subaward is one that exceeds \$25,000 in expenditures per year. For this reason, you do not need to include subawards, subgrants, or subcontracts that are smaller than \$25,000, nor do you need to include the first \$25,000 of payments in subawards, subgrants, or subcontracts that are larger than \$25,000.

The entity that you distribute funds to in a subaward, subgrant, or subcontract is called a subrecipient. Unlike other entities to whom your district may give funds, a subrecipient is responsible for managing the technical and administrative aspects of the work your district hires the subrecipient to perform. Your district holds the entity responsible for the project's proposal of work and its outcomes. The following are other characteristics of a subrecipient:

1. Determines who is eligible to receive what federal financial assistance.
2. Has its performance measured against whether the objectives of the federal program are met.
3. Has responsibility for programmatic decision making.
4. Has responsibility for adherence to applicable federal program compliance requirements.
5. Uses the federal funds to carry out a program of the organization as compared to providing goods or services for a program of the pass-through entity.

Please see OMB Circular A-133 §____.210 for more information (Appendix V).

Service Providers

Many districts distribute funds to service providers that provide consulting or technical services. These entities *are not considered subrecipients*, and payments to them must not be included in the subrecipient items tab of the ICRP.

Service providers are not responsible for meeting the objectives of a grant, nor does their work involve programmatic collaboration with your district.

A district that hires a service provider incurs the administrative costs that are normally associated with fulfilling the objectives of a program.

OMB Circular A-133 gives additional characteristics of a service provider, which:

1. Provides the goods and services within normal business operations.
2. Provides similar goods or services to many different purchasers.
3. Operates in a competitive environment.
4. Provides goods or services that are ancillary to the operation of the federal program.
5. Is not subject to compliance requirements of the federal program.

APPENDIX III: Function Codes

School districts must comply with the financial accounting and reporting rules given in Module 1 of the FASRG. According to the FAR, school districts must identify all of their governmental fund expenditures by specific function codes. The function codes your district uses in your own accounting records can help you classify your actual costs correctly in the ICRP.

The chart below lists function codes commonly used by school districts and provides the appropriate cost classification for most of the costs within each function code.

Function Code	Description	Cost Classification
11 Instruction	R11 Instruction. This function is used for activities that deal directly with the interaction between teachers and students. Teaching may be provided for students in a school classroom, in another location such as a home or hospital, and in other learning situations. It may also be provided through some other approved medium such as television, radio, telephone, telecommunications, multimedia and correspondence. This function includes expenditures/expenses for direct classroom instruction and other activities that deliver, enhance or direct the delivery of learning situations to students.	direct costs
12 Instructional Resources and Media Services	R12 Instructional Resources and Media Services. This function is used for expenditures/expenses that are directly and exclusively used for resource centers, establishing and maintaining libraries and other major facilities dealing with educational resources and media.	direct costs
13 Curriculum and Instructional Staff Development	R13 Curriculum Development and Instructional Staff Development. This function is used for expenditures/expenses that are directly and exclusively used to aid instructional staff in planning, developing and evaluating the process of providing learning experiences for students. Expenditures and expenses include in-service training and other staff development for instructional or instructional-related personnel (Functions 11, 12, and 13) of the school district. This function also includes expenditures and expenses related to research and development activities that investigate, experiment, and/or follow-through with the development of new or modified instructional methods, techniques, procedures, services, etc.	direct costs
21 Instructional Leadership	R21 Instructional Leadership. This function is used for expenditures/expenses that are directly used for managing, directing, supervising, and providing leadership for staff who provide general and specific instructional services.	direct costs

Function Code	Description	Cost Classification
23 School Leadership	R23 School Leadership. This function is used for expenditures/expenses that are used to direct and manage a school campus. They include the activities performed by the principal, assistant principals and other assistants while they: Supervise all operations of the campus; Evaluate staff members of the campus; Assign duties to staff members maintaining the records of the students on the campus	direct costs
31 Guidance and Counseling Service	R31 Guidance, Counseling and Evaluation Services. This function is used for expenditures/expenses that are directly and exclusively used for assessing and testing students' abilities, aptitudes and interests; counseling students with respect to career and educational opportunities and helping them establish realistic goals. This function includes costs of psychological services, identification of individual characteristics, testing, educational counseling, student evaluation and occupational counseling.	direct costs
32 Social Work Services	R32 Social Work Services. This function is used for expenditures/expenses that are directly and exclusively used for activities such as: investigating and diagnosing student social needs arising out of the home, school or community; casework and group work services for the child, parent or both; interpreting the social needs of students for other staff members; promoting modification of the circumstances surrounding the individual student which are related to his or her social needs. (This includes referrals to and interaction with other governmental agencies.)	direct costs
33 Health Services	R33 Health Services. This function is used for expenditures/expenses that are directly and exclusively used for providing physical health services to students. This includes activities that provide students with appropriate medical, dental and nursing services.	direct costs
34 Student (Pupil) Transportation	R34 Student (Pupil) Transportation. This function is used for expenditures/expenses that are incurred for transporting students to and from school. Expenditures/expenses for regular bus routes to and from school are to be recorded using Program Intent Code 99 (Undistributed), and Organization Code 999 (Undistributed) or Organization Code 998 (Unallocated, Local Option). Expenditures/expenses for transportation specifically and exclusively for purposes of transporting students relating to enhanced program intents such as Career and Technical and Services to Students with Disabilities (Special Education), etc., are to be recorded in Function 34 with the appropriate program intent codes.	direct costs

Function Code	Description	Cost Classification
35 Food Service	R35 Food Services. This function is used for food service operation expenditures/expenses, including the cost of food, labor, and other expenditures/expenses necessary for the preparation, transportation and storage of food to provide to students and staff. Expenditures/expenses are used directly and exclusively for supervision and maintenance of a food service operation.	direct costs
36 Cocurricular/ Extracurricular Activities	R36 Extracurricular Activities. This function is used for expenditures/expenses for school-sponsored activities outside of the school day. These activities are generally designed to provide students with experiences such as motivation and the enjoyment and improvement of skills in either a competitive or noncompetitive setting. Extracurricular activities include athletics and other activities that normally involve competition between schools (and frequently involve offsetting gate receipts or fees such as football, baseball, volleyball, track and tennis). Other kinds of related activities are included (such as drill team, pep squad and cheerleading, University Interscholastic League competition such as one-act plays, speech, debate, band, Future Farmers of America (FFA), National Honor Society, etc.). If the school district has activity funds, the goods purchased for resale are to be classified in this function, with the gross sale of goods recorded in Revenue Object Code 5755, Results from Enterprising Activities, Activity Funds and/or Clearing Accounts.	direct costs
41 General Administration	R4I General Administration. This function is for expenditures/expenses that are for purposes of managing or governing the school district as an overall entity. This function covers multiple activities that are not directly and exclusively used for costs applicable to specific functions.	indirect costs
41 General Administration	R4I General Administration. This function is for expenditures/expenses that are for purposes of managing or governing the school district as an overall entity. This function covers multiple activities that are not directly and exclusively used for costs applicable to specific functions.	direct costs
51 Plant Maintenance and Operations	R51 Facilities Maintenance and Operations. This function is used for expenditures/expenses for activities to keep the facilities and grounds open, clean, comfortable and in effective working condition and state of repair, and insured. This function is used to record expenditures/expenses for the maintenance and operation of the physical facilities and grounds. This function also includes expenditures/expenses associated with warehousing and receiving services.	direct costs

Function Code		Description	Cost Classification
51	Plant Maintenance and Operations	R51 Facilities Maintenance and Operations. This function is used for expenditures/expenses for activities to keep the facilities and grounds open, clean, comfortable and in effective working condition and state of repair, and insured. This function is used to record expenditures/expenses for the maintenance and operation of the physical facilities and grounds. This function also includes expenditures/expenses associated with warehousing and receiving services.	indirect costs
52	Security and Monitoring Services	R52 Security and Monitoring Services. This function is used for expenditures/expenses that are for activities to keep student and staff surroundings safe, whether in transit to or from school, on a campus or participating in school-sponsored events at another location.	direct costs
52	Security and Monitoring Services	R52 Security and Monitoring Services. This function is used for expenditures/expenses that are for activities to keep student and staff surroundings safe, whether in transit to or from school, on a campus or participating in school-sponsored events at another location.	indirect costs
53	Data Processing Services	R53 Data Processing Services. This function is for expenditures/expenses for data processing services, whether in-house or contracted. Examples of Function 53 costs are costs for computer facility management; computer processing; systems development; analysis of workflows, processes and requirements; coding, testing, debugging and documentation; systems integration; design of applications supporting information technology infrastructure; maintenance of programs; maintenance of networks; and those interfacing costs associated with general types of technical assistance to data users. Specific types of applications include student accounting, financial accounting and human resources/personnel. Personal Computers (PC's) that are stand alone are to be charged to the appropriate function. Peripherals including terminals and printers are to be charged to the appropriate function. Costs associated with mainframe, minicomputers, servers and networked or standalone microcomputers that provide services to multiple functions are to be recorded here.	direct costs
53	Data Processing Services	R53 Data Processing Services. This function is for expenditures/expenses for data processing services, whether in-house or contracted. Examples of Function 53 costs are costs for computer facility management; computer processing; systems development; analysis of workflows, processes and requirements; coding, testing,	indirect costs

Function Code	Description	Cost Classification
	debugging and documentation; systems integration; design of applications supporting information technology infrastructure; maintenance of programs; maintenance of networks; and those interfacing costs associated with general types of technical assistance to data users. Specific types of applications include student accounting, financial accounting and human resources/personnel. Personal Computers (PC's) that are stand alone are to be charged to the appropriate function. Peripherals including terminals and printers are to be charged to the appropriate function. Costs associated with mainframe, minicomputers, servers and networked or standalone microcomputers that provide services to multiple functions are to be recorded here.	
62 School District Administrative Support Services	R 62 School District Administrative Support Services (Used by Education Service Centers Only). This function code is to be used exclusively by education service centers for expenditures related to performing certain administrative functions for school districts. These services can include indirect instructional services for students such as guidance and counseling, social work, health and food services as well as general administrative services such as fiscal budget, accounting, joint purchasing, tax administration, SAS preparation services, etc. This function is used by education service centers for region-wide activities that encompass inservice education and other developmental activities provided to indirect instructional or instructional related school district professional personnel (i.e., professional personnel in functions other than 11, 12 and 13).	direct costs
71 Debt Service: Principal on Long Term Debt	R 71 Debt Service. This function is used for expenditures that are for the retirement of recurring bond, capital lease principal, and other debt, related debt service fees, and for all debt interest. Note principal for short-term loans (one year or less in duration) is to be recorded in the liability account 2122, Notes Payable—Current Year.	excluded costs
81 Facilities Acquisition and Construction	R81 Facilities Acquisition and Construction. This function is used by school districts for expenditures that are for acquiring, equipping, and/or making additions to real property and sites, including lease and capital lease transactions.	excluded costs
91 Contracted Instructional	R91 Contracted Instructional Services Between Public Schools. This function code is used for expenditures for: Providing financial resources for services in another public school through a contract for education of nonresident students under	excluded costs

Function Code	Description	Cost Classification
Services Between Public Schools	Subchapter E, Chapter 41, TEC; Purchasing attendance credits from the state under Subchapter D, Chapter 41, TECR 91 Contracted Instructional Services Between Public Schools; Providing financial resources for services in another public school through a contract for education of nonresident students under Subchapter E, Chapter 41, TEC; Purchasing attendance credits from the state under Subchapter D, Chapter 41, TEC Costs for contractual arrangements under Subchapter E, Chapter 41, are recorded under this function code only if the agreement is to pay for services managed and administered by another school district receiving payments under Subchapter E, Chapter 41, TEC. <i>This function is exclusive for the purchase of Weighted Average Daily Attendance (WADA).</i>	
92 Incremental Costs Associated with Chapter 41, Texas Education Code, Purchase or Sale of WADA	R92 Incremental Costs Associated with Chapter 41, Texas Education Code, Purchase or Sale of WADA. This function code is used for expenditures that are for the purpose of positioning a school district with excess wealth per WADA to purchase attendance credits either from the state or from other school districts.	excluded costs
93 Payments to Fiscal Agent/Member Districts of Shared Services Arrangements	R93 Payments to Fiscal Agent/Member Districts of Shared Services Arrangements. This function code is used for expenditures that are for (1) payments from a member district to a fiscal agent of a shared services arrangement; or, (2) payments from a fiscal agent to a member district of a shared services arrangement.	excluded costs
95 Payments to Juvenile Justice Alternative Education Programs	R95 Payments to Juvenile Justice Alternative Education Programs. This function code is used for expenditures that are for the purpose of providing financial resources for Juvenile Justice Alternative Education Programs under Chapter 37, TEC. This function code is used to account for payments to other governmental entities in connection with students that are placed in discretionary or mandatory JJAEP settings.	excluded costs
97 Payments to Tax Increment Fund	R97 Payments to Tax Increment Fund. This function code is used for expenditures that are for the purpose of providing financial resources paid into a tax increment fund under Chapter 311, Tax Code. The expenditures are recorded under fund 199, Object 6499.	excluded costs

Function Code	Description	Cost Classification
99 Other Intergovernmental Charges	R99 Other Intergovernmental Charges. This code is used to record other intergovernmental charges not defined above. This function code is also used for expenditures that are used for obtaining instructional services from another public school for grade levels not served in a school district under Section 25.039, TEC.	excluded costs
99 Other Intergovernmental Charges	Object Code 6213. Amounts paid to other governmental entities such as county appraisal districts for costs related to the appraisal of property.	unallowable costs

APPENDIX IV: Object Codes

School districts must comply with the financial accounting and reporting rules given in Module 1 of the FASRG. According to the FAR, school districts must identify all of their governmental fund expenditures by specific object codes. The object codes your district uses in its own accounting records can help you classify your actual costs correctly in the ICRP.

The chart below lists operating expense object codes used by school districts and explains how specific items should be classified within each object code.

Object Code		Explanation
611X–6149	Payroll Costs	<p>Salaries and fixed costs for staff in accounting, budgeting, payroll, human resources, purchasing, and employee relations are indirect costs.</p> <p>Salaries and fixed costs related to the direction and supervision of such functions as instruction, guidance, attendance, transportation, community services, and student services are direct costs.</p> <p>Examples:</p> <ul style="list-style-type: none"> • A business manager's salary should be classified as an indirect cost. • A supervisor of transportation's salary should be classified as a direct cost. <p>If the business manager is also the supervisor of transportation, classify a portion of his or her salary to each cost classification based upon the amount of time spent performing each function</p>
6211	Legal Services	Legal fees are direct costs.
6212	Audit Services	Audit services are indirect cost.
6213	Tax Appraisal and Collection	Tax appraisal and collection costs are unallowable costs.
6214	Lobbying	Lobbying costs are unallowable costs.
621X	Professional Services	<p>Professional services costs can be classified as either direct or indirect costs. Your district must determine which area benefits from the service in order to classify the cost correctly.</p> <p>Payroll, inventory, accounts receivable, accounting and personnel records processing costs should be classified as indirect costs because they benefit the entire school district.</p> <p>Student attendance accounting, class scheduling, grade reporting, special population, and transportation report costs should be classified as direct costs because they only benefit specific areas of the school district.</p> <p>Data processing, pupil appraisal, cocurricular event, and student assembly costs can be classified as either direct or indirect costs. Your district must determine which area of your district uses the service in order to classify the cost</p>

Object Code		Explanation
		correctly. In general, services used by the entire district should be classified as indirect costs.
622X	Tuition and Transfer Payments	Tuition and transfer costs should be classified as either direct or indirect costs, depending on the district function that benefits.
623X	Education Service Center (ESC) Services	ESC services costs should be classified as either direct or indirect costs, depending on the district function that benefits.
624X	Contracted Maintenance and Repair Services	Contracted maintenance and repair costs should be classified as either direct or indirect costs, depending on the district function that benefits.
625X	Utilities	Utility costs should be classified as either direct or indirect costs, depending on the district function that benefits.
626X–629X	Rentals—Operating Leases through Miscellaneous Contracted Services	Rentals and miscellaneous contracted services costs should be classified as either direct or indirect costs, depending on the district function that benefits.
631X	Supplies and Materials	Supplies and materials for maintenance and/or operations cost should be classified as either direct or indirect costs, depending on the district function that benefits.
632X and 633X	Textbooks and Other Reading Materials and Testing Materials	Books, magazines and periodicals, and testing materials are usually classified as direct costs. However, if any of the items relate to a district function that is classified as an indirect cost, the cost of the item should also be classified as an indirect cost.
634X	Food Service and Other Resale Items	Food service and other resale costs could be either direct, indirect or unallowable costs, depending on the district function that benefits. Any costs related to entertainment must be classified as unallowable.
639X	Supplies and Materials—General	General supplies and materials costs should be classified based upon a reasonable estimate of usage by the different 611X–6149 personnel to determine if the costs are direct, unallowable, or indirect.
641X	Travel, Subsistence, and Stipends	Travel and subsistence costs usually relate on a one-to-one basis to salary position costs, and can be classified into the same cost categories in which the salaries are classified. Costs that do not relate to specific salary positions should be

Object Code		Explanation
		classified the same way as the district function that benefits from the travel or subsistence. Costs related to entertainment must be classified as unallowable.
642X	Insurance and Bonding Costs	Insurance and bonding costs usually relate on a one-to-one basis to a salaried position, and can be classified into the same cost categories in which the salaries are classified. Costs that do not relate to specific salary positions should be classified the same way as the district function that benefits from the insurance or bonding.
643X	Election Costs	Election costs are a school board expense and should be classified as unallowable.
649X	Miscellaneous Operating Costs	Miscellaneous operating costs should be classified as either direct or indirect costs, depending on the district function that benefits.
65XX– 66XX	Debt Service through Capital Outlay—Land, Buildings and Equipment	All costs for debt service (6500) and capital outlay (6600) must be classified as excluded costs.

APPENDIX V: Relevant Federal Statutes

Restricted Rate Formula

34 CFR §76.564 Restricted indirect cost rate-formula.

(a) An indirect cost rate for a grant covered by §76.563 or 34 CFR 75.563 is determined by the following formula:

Restricted indirect cost rate = (General management costs + Fixed costs) ÷ (Other expenditures)

(b) General management costs, fixed costs, and other expenditures must be determined under §76.565 through §76.567.

(c) Under the programs covered by §76.563, a subgrantee of an agency of a state or a local government (as those terms are defined in 34 CFR 80.3) or a grantee subject to 34 CFR 75.563 that is not a state or local government agency may use-

(1) An indirect cost rate computed under paragraph (a) of this section; or

(2) An indirect cost rate of eight percent unless the Secretary determines that the subgrantee or grantee would have a lower rate under paragraph (a) of this section.

(d) Indirect costs that are unrecovered as a result of these restrictions may not be charged directly, used to satisfy matching or cost-sharing requirements, or charged to another federal award.

(Authority: 20 USC 1221e-3(a)(1), 2831(a), 2974(b), and 3474) [59 FR 59583, Nov. 17, 1994]

General Management Costs

34 CFR §76.565 General management costs-restricted rate.

(a) As used in §76.564, *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 certain 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.

(d) For purposes of this section-

(1) The chief executive officer of the grantee is the individual who is the head of the executive office of the grantee and exercises overall responsibility for the operation and management of the organization. The chief executive officer's immediate office includes any deputy chief executive officer or similar officer along with immediate support staff of these individuals. The term does not include the governing body of the grantee, such as a board or a similar elected or appointed governing body; and

(2) Components of the grantee are those organizational units supervised directly or indirectly by the chief executive officer. These organizational units generally exist one management level below the executive office of the grantee. The term does not include the office of the chief executive officer or a deputy chief executive officer or similar position.

(Authority: 20 USC 1221e–3(a)(1), 2831(a), 2974(b), and 3474) [59 FR 59583, Nov. 17, 1994]

Fixed Costs

34 CFR §76.566 Fixed costs-restricted rate.

As used in §76.564, *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.

(Authority: 20 USC 1221e–3(a)(1), 2831(a), 2974(b), and 3474) [59 FR 59583, Nov. 17, 1994]

Other Expenditures

34 CFR §76.567 Other expenditures-restricted rate.

(a) As used in §76.564, *other expenditures* means the grantee's total expenditures for its federally- and non-federally funded activities in the most recent year for which data are available. The term also includes direct occupancy and space maintenance costs as determined under §76.568 and costs related to the chief executive officers of the grantee and components of the grantee and their offices (see §76.565(c) and (d)).

(b) The term does not include-

- (1) General management costs determined under §76.565;
- (2) Fixed costs determined under §76.566;
- (3) Subgrants;
- (4) Capital outlay;
- (5) Debt service;

(6) Fines and penalties;

(7) Contingencies; and

(8) Election expenses. However, the term does include election expenses that result from elections required by an applicable federal statute.

(Authority: 20 USC 1221e–3(a)(1), 2831(a), 2974(b), and 3474) [59 FR 59583, Nov. 17, 1994]

Occupancy and Space Maintenance Costs

34 CFR §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 as general management costs 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 expenditures in the indirect cost formula. These costs may be charged directly to affected programs only to the extent that statutory supplanting prohibitions are not violated. This reimbursement must be approved in advance by the Secretary.

(Authority: 20 USC 1221e–3(a)(1), 2831(a), 2974(b), and 3474) [59 FR 59584, Nov. 17, 1994]

Cost Allocations for State and Local Government, USDE

Section II (C)

3. Determine Direct Costs

Direct costs are those that can be identified specifically with a particular cost objective. The direct costs of a federal award can be specifically identified to the program and may be charged directly to the program. Examples of direct costs that may be charged to a federal program include the following:

Compensation of the employees who works on the program;

Supplies and materials used for the program;

Equipment purchased and used for the program; and

Travel expenses incurred specifically to carry out the program.

4. Determine Indirect Costs

OMB Circular A-87 defines indirect costs as those that are incurred for a common or joint purpose benefiting more than one cost objective. In addition, indirect costs cannot be readily identified as benefiting a particular cost objective. Examples of indirect costs include the salaries and expenses for the following:

Data Processing

Accounting

Personnel

Purchasing

Indirect costs are normally charged to federal programs through the indirect cost rate. Grantees must be consistent in treating costs as direct or indirect under federal awards. Once a cost is treated as direct or indirect, it should be treated that way for all projects and activities, regardless of the source of funding.

OMB A-87, Attachment A—General Principles for Determining Allowable Costs

C. Basic Guidelines

1. Factors affecting allowability of costs. To be allowable under federal awards, costs must meet the following general criteria:

a. Be necessary and reasonable for proper and efficient performance and administration of federal awards.

b. Be allocable to federal awards under the provisions of this Circular.

c. Be authorized or not prohibited under state or local laws or regulations.

d. Conform to any limitations or exclusions set forth in these principles, federal laws, terms and conditions of the federal award, or other governing regulations as to types or amounts of cost items.

e. Be consistent with policies, regulations, and procedures that apply uniformly to both federal awards and other activities of the governmental unit.

f. Be accorded consistent treatment. A cost may not be assigned to a federal award as a direct cost if any other cost incurred for the same purpose in like circumstances has been allocated to the federal award as an indirect cost.

g. Except as otherwise provided for in this Circular, be determined in accordance with generally accepted accounting principles.

h. Not be included as a cost or used to meet cost sharing or matching requirements of any other federal award in either the current or a prior period, except as specifically provided by federal law or regulation.

i. Be the net of all applicable credits.

j. Be adequately documented.

D. Composition of Cost

2. Classification of costs. There is no universal rule for classifying certain costs as either direct or indirect under every

accounting system. A cost may be direct with respect to some specific service or function, but indirect with respect to the federal award or other final cost objective. Therefore, it is essential that each item of cost be treated consistently in like circumstances either as a direct or an indirect cost. Guidelines for determining direct and indirect costs charged to federal awards are provided in the sections that follow.

E. Direct Costs

1. General. Direct costs are those that can be identified specifically with a particular final cost objective.
2. Application. Typical direct costs chargeable to federal awards are:
 - a. Compensation of employees for the time devoted and identified specifically to the performance of those awards.
 - b. Cost of materials acquired, consumed, or expended specifically for the purpose of those awards.
 - c. Equipment and other approved capital expenditures.
 - d. Travel expenses incurred specifically to carry out the award.
3. Minor items. Any direct cost of a minor amount may be treated as an indirect cost for reasons of practicality where such accounting treatment for that item of cost is consistently applied to all cost objectives.

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 benefitted, 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 benefitted 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.

- a. In addition to restrictions contained in this Circular, there may be laws that further limit the amount of administrative or indirect cost allowed.
- b. 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.

OMB A-87, Attachment B

1. Advertising and public relations costs

- a. The term advertising costs means the costs of advertising media and corollary administrative costs. Advertising media include magazines, newspapers, radio and television, direct mail, exhibits, electronic or computer transmittals, and the like.
- b. The term public relations includes community relations and means those activities dedicated to maintaining the image of the governmental unit or maintaining or promoting understanding and favorable relations with the community or public at large or any segment of the public.
- c. The only allowable advertising costs are those which are solely for:

- (1) The recruitment of personnel required for the performance by the governmental unit of obligations arising under a federal award ;
- (2) The procurement of goods and services for the performance of a federal award;
- (3) The disposal of scrap or surplus materials acquired in the performance of a federal award except when governmental units are reimbursed for disposal costs at a predetermined amount; or
- (4) Other specific purposes necessary to meet the requirements of the federal award.

d. The only allowable public relations costs are:

- (1) Costs specifically required by the federal award;
- (2) Costs of communicating with the public and press pertaining to specific activities or accomplishments which result from performance of federal awards (these costs are considered necessary as part of the outreach effort for the federal award); or
- (3) Costs of conducting general liaison with news media and government public relations officers, to the extent that such activities are limited to communication and liaison necessary keep the public informed on matters of public concern, such as notices of federal contract/grant awards, financial matters, etc.

e. Costs identified in subsections c and d if incurred for more than one federal award or for both sponsored work and other work of the governmental unit, are allowable to the extent that the principles in Attachment A, sections E. ("Direct Costs") and F. ("Indirect Costs") are observed.

f. Unallowable advertising and public relations costs include the following:

- (1) All advertising and public relations costs other than as specified in subsections c, d, and e;
- (2) Costs of meetings, conventions, convocations, or other events related to

other activities of the governmental unit, including:

- (a) Costs of displays, demonstrations, and exhibits;
- (b) Costs of meeting rooms, hospitality suites, and other special facilities used in conjunction with shows and other special events; and
- (c) Salaries and wages of employees engaged in setting up and displaying exhibits, making demonstrations, and providing briefings;
- (3) Costs of promotional items and memorabilia, including models, gifts, and souvenirs;
- (4) Costs of advertising and public relations designed solely to promote the governmental unit.

2. Advisory councils

Costs incurred by advisory councils or committees are allowable as a direct cost where authorized by the federal awarding agency or as an indirect cost where allocable to federal awards.

3. Alcoholic beverages

Costs of alcoholic beverages are unallowable.

4. Audit costs and related services

- a. The costs of audits required by, and performed in accordance with, the Single Audit Act, as implemented by Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations" are allowable. Also see 31 USC 7505(b) and section 230 ("Audit Costs") of Circular A-133.
- b. Other audit costs are allowable if included in a cost allocation plan or indirect cost proposal, or if specifically approved by the awarding agency as a direct cost to an award.
- c. The cost of agreed-upon procedures engagements to monitor subrecipients

who are exempted from A-133 under section 200(d) are allowable, subject to the conditions listed in A-133, section 230 (b)(2).

5. Bad debts

Bad debts, including losses (whether actual or estimated) arising from uncollectable accounts and other claims, related collection costs, and related legal costs, are unallowable.

6. Bonding costs

- a. Bonding costs arise when the federal government requires assurance against financial loss to itself or others by reason of the act or default of the governmental unit. They arise also in instances where the governmental unit requires similar assurance. Included are such bonds as bid, performance, payment, advance payment, infringement, and fidelity bonds.
- b. Costs of bonding required pursuant to the terms of the award are allowable.
- c. Costs of bonding required by the governmental unit in the general conduct of its operations are allowable to the extent that such bonding is in accordance with sound business practice and the rates and premiums are reasonable under the circumstances.

7. Communication costs

Costs incurred for telephone services, local and long distance telephone calls, telegrams, postage, messenger, electronic or computer transmittal services and the like are allowable.

8. Compensation for personal services

- a. General. Compensation for personnel services includes all remuneration, paid currently or accrued, for services rendered during the period of performance under federal awards, including but not necessarily limited to wages, salaries, and fringe benefits. The

costs of such compensation are allowable to the extent that they satisfy the specific requirements of this Circular, and that the total compensation for individual employees:

- (1) Is reasonable for the services rendered and conforms to the established policy of the governmental unit consistently applied to both federal and non federal activities;
 - (2) Follows an appointment made in accordance with a governmental unit's laws and rules and meets merit system or other requirements required by federal law, where applicable; and
 - (3) Is determined and supported as provided in subsection h.
- b. Reasonableness. Compensation for employees engaged in work on federal awards will be considered reasonable to the extent that it is consistent with that paid for similar work in other activities of the governmental unit. In cases where the kinds of employees required for federal awards are not found in the other activities of the governmental unit, compensation will be considered reasonable to the extent that it is comparable to that paid for similar work in the labor market in which the employing government competes for the kind of employees involved. Compensation surveys providing data representative of the labor market involved will be an acceptable basis for evaluating reasonableness.
 - c. Unallowable costs. Costs which are unallowable under other sections of these principles shall not be allowable under this section solely on the basis that they constitute personnel compensation.
 - d. Fringe benefits.
 - (1) Fringe benefits are allowances and services provided by employers to their employees as compensation in addition to regular salaries and wages. Fringe benefits include, but are not limited to, the costs of

leave, employee insurance, pensions, and unemployment benefit plans. Except as provided elsewhere in these principles, the costs of fringe benefits are allowable to the extent that the benefits are reasonable and are required by law, governmental unit employee agreement, or an established policy of the governmental unit.

(2) The cost of fringe benefits in the form of regular compensation paid to employees during periods of authorized absences from the job, such as for annual leave, sick leave, holidays, court leave, military leave, and other similar benefits, are allowable if: (a) they are provided under established written leave policies; (b) the costs are equitably allocated to all related activities, including federal awards; and, (c) the accounting basis (cash or accrual) selected for costing each type of leave is consistently followed by the governmental unit.

(3) When a governmental unit uses the cash basis of accounting, the cost of leave is recognized in the period that the leave is taken and paid for. Payments for unused leave when an employee retires or terminates employment are allowable in the year of payment provided they are allocated as a general administrative expense to all activities of the governmental unit or component.

(4) The accrual basis may be only used for those types of leave for which a liability as defined by Generally Accepted Accounting Principles (GAAP) exists when the leave is earned. When a governmental unit uses the accrual basis of accounting, in accordance with GAAP, allowable leave costs are the lesser of the amount accrued or funded.

(5) The cost of fringe benefits in the form of employer contributions or expenses for social security; employee life, health, unemployment, and worker's compensation insurance (except as indicated in section 22, Insurance and indemnification); pension plan costs (see subsection e.); and other similar benefits are allowable, provided such benefits are granted under established written policies. Such benefits, whether

treated as indirect costs or as direct costs, shall be allocated to federal awards and all other activities in a manner consistent with the pattern of benefits attributable to the individuals or groups of employees whose salaries and wages are chargeable to such federal awards and other activities.

e. Pension plan costs. Pension plan costs may be computed using a pay as you go method or an acceptable actuarial cost method in accordance with established written policies of the governmental unit.

(1) For pension plans financed on a pay as you go method, allowable costs will be limited to those representing actual payments to retirees or their beneficiaries.

(2) Pension costs calculated using an actuarial cost based method recognized by GAAP are allowable for a given fiscal year if they are funded for that year within six months after the end of that year. Costs funded after the six month period (or a later period agreed to by the cognizant agency) are allowable in the year funded. The cognizant agency may agree to an extension of the six month period if an appropriate adjustment is made to compensate for the timing of the charges to the federal government and related federal reimbursement and the governmental unit's contribution to the pension fund. Adjustments may be made by cash refund or other equitable procedures to compensate the federal government for the time value of federal reimbursements in excess of contributions to the pension fund.

(3) Amounts funded by the governmental unit in excess of the actuarially determined amount for a fiscal year may be used as the governmental unit's contribution in future periods.

(4) When a governmental unit converts to an acceptable actuarial cost method, as defined by GAAP, and funds pension costs in accordance with this method, the unfunded liability at the time of conversion shall be allowable if amortized over a period of years in accordance with GAAP.

(5) The federal government shall receive an equitable share of any previously allowed pension costs (including earnings thereon) which revert or inure to the governmental unit in the form of a refund, withdrawal, or other credit.

f. Post retirement health benefits. Post retirement health benefits (PRHB) refers to costs of health insurance or health services not included in a pension plan covered by subsection e. for retirees and their spouses, dependents, and survivors. PRHB costs may be computed using a pay as you go method or an acceptable actuarial cost method in accordance with established written policies of the governmental unit.

(1) For PRHB financed on a pay as you go method, allowable costs will be limited to those representing actual payments to retirees or their beneficiaries.

(2) PRHB costs calculated using an actuarial cost method recognized by GAAP are allowable if they are funded for that year within six months after the end of that year. Costs funded after the six month period (or a later period agreed to by the cognizant agency) are allowable in the year funded. The cognizant agency may agree to an extension of the six month period if an appropriate adjustment is made to compensate for the timing of the charges to the federal government and related federal reimbursements and the governmental unit's contributions to the PRHB fund. Adjustments may be made by cash refund, reduction in current year's PRHB costs, or other equitable procedures to compensate the federal government for the time value of federal reimbursements in excess of contributions to the PRHB fund.

(3) Amounts funded in excess of the actuarially determined amount for a fiscal year may be used as the government's contribution in a future period.

(4) When a governmental unit converts to an acceptable actuarial cost method and funds PRHB costs in accordance with this

method, the initial unfunded liability attributable to prior years shall be allowable if amortized over a period of years in accordance with GAAP, or, if no such GAAP period exists, over a period negotiated with the cognizant agency.

(5) To be allowable in the current year, the PRHB costs must be paid either to:

(a) An insurer or other benefit provider as current year costs or premiums, or

(b) An insurer or trustee to maintain a trust fund or reserve for the sole purpose of providing post retirement benefits to retirees and other beneficiaries.

(6) The federal government shall receive an equitable share of any amounts of previously allowed post retirement benefit costs (including earnings thereon) which revert or inure to the governmental unit in the form of a refund, withdrawal, or other credit.

g. Severance pay.

(1) Payments in addition to regular salaries and wages made to workers whose employment is being terminated are allowable to the extent that, in each case, they are required by (a) law, (b) employer employee agreement, or (c) established written policy.

(2) Severance payments (but not accruals) associated with normal turnover are allowable. Such payments shall be allocated to all activities of the governmental unit as an indirect cost.

(3) Abnormal or mass severance pay will be considered on a case by case basis and is allowable only if approved by the cognizant federal agency.

h. Support of salaries and wages. These standards regarding time distribution are in addition to the standards for payroll documentation.

(1) Charges to federal awards for salaries and wages, whether treated as direct or indirect costs, will be based on payrolls documented in accordance with generally

accepted practice of the governmental unit and approved by a responsible official of the governmental unit.

(2) No further documentation is required for the salaries and wages of employees who work in a single indirect cost activity.

(3) Where employees are expected to work solely on a single federal award or cost objective, charges for their salaries and wages will be supported by periodic certifications that the employees worked solely on that program for the period covered by the certification. These certifications will be prepared at least semi annually and will be signed by the employee or supervisory official having first hand knowledge of the work performed by the employee.

(4) Where employees work on multiple activities or cost objectives, a distribution of their salaries or wages will be supported by personnel activity reports or equivalent documentation which meets the standards in subsection (5) unless a statistical sampling system (see subsection (6)) or other substitute system has been approved by the cognizant federal agency. Such documentary support will be required where employees work on:

- (a) More than one federal award,
- (b) A federal award and a non federal award,
- (c) An indirect cost activity and a direct cost activity,
- (d) Two or more indirect activities which are allocated using different allocation bases, or
- (e) An unallowable activity and a direct or indirect cost activity.

(5) Personnel activity reports or equivalent documentation must meet the following standards:

- (a) They must reflect an after the fact distribution of the actual activity of each employee,
- (b) They must account for the total activity for which each employee is compensated,

(c) They must be prepared at least monthly and must coincide with one or more pay periods, and

(d) They must be signed by the employee.

(e) Budget estimates or other distribution percentages determined before the services are performed do not qualify as support for charges to federal awards but may be used for interim accounting purposes, provided that:

(i) The governmental unit's system for establishing the estimates produces reasonable approximations of the activity actually performed;

(ii) At least quarterly, comparisons of actual costs to budgeted distributions based on the monthly activity reports are made. Costs charged to federal awards to reflect adjustments made as a result of the activity actually performed may be recorded annually if the quarterly comparisons show the differences between budgeted and actual costs are less than ten percent; and

(iii) The budget estimates or other distribution percentages are revised at least quarterly, if necessary, to reflect changed circumstances.

(6) Substitute systems for allocating salaries and wages to federal awards may be used in place of activity reports. These systems are subject to approval if required by the cognizant agency. Such systems may include, but are not limited to, random moment sampling, case counts, or other quantifiable measures of employee effort.

(a) Substitute systems which use sampling methods (primarily for Temporary Assistance to Needy Families (TANF), Medicaid, and other public assistance programs) must meet acceptable statistical sampling standards including:

(i) The sampling universe must include all of the employees whose salaries and wages are to be allocated based on sample results except as provided in subsection (c);

(ii) The entire time period involved must be covered by the sample; and

(iii) The results must be statistically valid and applied to the period being sampled.

(b) Allocating charges for the sampled employees' supervisors, clerical and support staffs, based on the results of the sampled employees, will be acceptable.

(c) Less than full compliance with the statistical sampling standards noted in subsection (a) may be accepted by the cognizant agency if it concludes that the amounts to be allocated to federal awards will be minimal, or if it concludes that the system proposed by the governmental unit will result in lower costs to federal awards than a system which complies with the standards.

(7) Salaries and wages of employees used in meeting cost sharing or matching requirements of federal awards must be supported in the same manner as those claimed as allowable costs under federal awards.

i. Donated services.

(1) Donated or volunteer services may be furnished to a governmental unit by professional and technical personnel, consultants, and other skilled and unskilled labor. The value of these services is not reimbursable either as a direct or indirect cost. However, the value of donated services may be used to meet cost sharing or matching requirements in accordance with the provisions of the Common Rule.

(2) The value of donated services utilized in the performance of a direct cost activity shall, when material in amount, be considered in the determination of the governmental unit's indirect costs or rates and, accordingly, shall be allocated a proportionate share of applicable indirect costs.

(3) To the extent feasible, donated services will be supported by the same methods used by the governmental unit to support

the allocability of regular personnel services.

9. Contingency provisions

Contributions to a contingency reserve or any similar provision made for events the occurrence of which cannot be foretold with certainty as to time, intensity, or with an assurance of their happening, are unallowable. The term "contingency reserve" excludes self-insurance reserves (see Attachment B, section 22.c.), pension plan reserves (see Attachment B, section 8.e.), and post-retirement health and other benefit reserves (see Attachment B, section 8.f.) computed using acceptable actuarial cost methods.

10. Defense and prosecution of criminal and civil proceedings, and claims

a. The following costs are unallowable for contracts covered by 10 USC 2324(k), "Allowable costs under defense contracts."

(1) Costs incurred in defense of any civil or criminal fraud proceeding or similar proceeding (including filing of false certification brought by the United States where the contractor is found liable or has pleaded nolo contendere to a charge of fraud or similar proceeding (including filing of a false certification)).

(2) Costs incurred by a contractor in connection with any criminal, civil or administrative proceedings commenced by the United States or a state to the extent provided in 10 USC 2324(k).

b. Legal expenses required in the administration of federal programs are allowable. Legal expenses for prosecution of claims against the federal government are unallowable.

11. Depreciation and use allowances

a. Depreciation and use allowances are means of allocating the cost of fixed assets to periods benefiting from asset use. Compensation for the use of fixed

assets on hand may be made through depreciation or use allowances. A combination of the two methods may not be used in connection with a single class of fixed assets (e.g., buildings, office equipment, computer equipment, etc.) except as provided for in subsection g. Except for enterprise funds and internal service funds that are included as part of a state/local cost allocation plan, classes of assets shall be determined on the same basis used for the government-wide financial statements.

- b. The computation of depreciation or use allowances shall be based on the acquisition cost of the assets involved. Where actual cost records have not been maintained, a reasonable estimate of the original acquisition cost may be used. The value of an asset donated to the governmental unit by an unrelated third party shall be its fair market value at the time of donation. Governmental or quasi-governmental organizations located within the same state shall not be considered unrelated third parties for this purpose.
- c. The computation of depreciation or use allowances will exclude:
 - (1) The cost of land;
 - (2) Any portion of the cost of buildings and equipment borne by or donated by the federal government irrespective of where title was originally vested or where it presently resides; and
 - (3) Any portion of the cost of buildings and equipment contributed by or for the governmental unit, or a related donor organization, in satisfaction of a matching requirement.
- d. Where the depreciation method is followed, the period of useful service (useful life) established in each case for usable capital assets must take into consideration such factors as type of construction, nature of the equipment used, historical usage patterns,

technological developments, and the renewal and replacement policies of the governmental unit followed for the individual items or classes of assets involved. In the absence of clear evidence indicating that the expected consumption of the asset will be significantly greater in the early portions than in the later portions of its useful life, the straight line method of depreciation shall be used.

Depreciation methods once used shall not be changed unless approved by the federal cognizant or awarding agency. When the depreciation method is introduced for application to an asset previously subject to a use allowance, the annual depreciation charge thereon may not exceed the amount that would have resulted had the depreciation method been in effect from the date of acquisition of the asset. The combination of use allowances and depreciation applicable to the asset shall not exceed the total acquisition cost of the asset or fair market value at time of donation.

- e. When the depreciation method is used for buildings, a building's shell may be segregated from the major component of the building (e.g., plumbing system, heating, and air conditioning system, etc.) and each major component depreciated over its estimated useful life, or the entire building (i.e., the shell and all components) may be treated as a single asset and depreciated over a single useful life.
- f. Where the use allowance method is followed, the use allowance for buildings and improvements (including land improvements, such as paved parking areas, fences, and sidewalks) will be computed at an annual rate not exceeding two percent of acquisition costs. The use allowance for equipment will be computed at an annual rate not exceeding $6\frac{2}{3}$ percent of acquisition cost. When the use allowance method is used for buildings, the entire building

must be treated as a single asset; the building's components (e.g., plumbing system, heating and air condition, etc.) cannot be segregated from the building's shell.

The two percent limitation, however, need not be applied to equipment which is merely attached or fastened to the building but not permanently fixed to it and which is used as furnishings or decorations or for specialized purposes (e.g., dentist chairs and dental treatment units, counters, laboratory benches bolted to the floor, dishwashers, modular furniture, carpeting, etc.). Such equipment will be considered as not being permanently fixed to the building if it can be removed without the destruction of, or need for costly or extensive alterations or repairs, to the building or the equipment. Equipment that meets these criteria will be subject to the 6 2/3 percent equipment use allowance limitation.

- g. A reasonable use allowance may be negotiated for any assets that are considered to be fully depreciated, after taking into consideration the amount of depreciation previously charged to the government, the estimated useful life remaining at the time of negotiation, the effect of any increased maintenance charges, decreased efficiency due to age, and any other factors pertinent to the utilization of the asset for the purpose contemplated.
- h. Charges for use allowances or depreciation must be supported by adequate property records. Physical inventories must be taken at least once every two years (a statistical sampling approach is acceptable) to ensure that assets exist, and are in use. Governmental units will manage equipment in accordance with state laws and procedures. When the depreciation method is followed, depreciation records indicating the amount of depreciation taken each period must also be maintained.

12. Donations and contributions

- a. Contributions or donations rendered. Contributions or donations, including cash, property, and services, made by the governmental unit, regardless of the recipient, are unallowable.
- b. Donated services received:
 - (1) Donated or volunteer services may be furnished to a governmental unit by professional and technical personnel, consultants, and other skilled and unskilled labor. The value of these services is not reimbursable either as a direct or indirect cost. However, the value of donated services may be used to meet cost sharing or matching requirements in accordance with the Federal Grants Management Common Rule.
 - (2) The value of donated services utilized in the performance of a direct cost activity shall, when material in amount, be considered in the determination of the governmental unit's indirect costs or rates and, accordingly, shall be allocated a proportionate share of applicable indirect costs.
 - (3) To the extent feasible, donated services will be supported by the same methods used by the governmental unit to support the allocability of regular personnel services.

13. Employee morale, health, and welfare costs

- a. The costs of employee information publications, health or first-aid clinics and/or infirmaries, recreational activities, employee counseling services, and any other expenses incurred in accordance with the governmental unit's established practice or custom for the improvement of working conditions, employer-employee relations, employee morale, and employee performance are allowable.
- b. Such costs will be equitably apportioned to all activities of the governmental unit.

Income generated from any of these activities will be offset against expenses.

14. Entertainment

Costs of entertainment, including amusement, diversion, and social activities and any costs directly associated with such costs (such as tickets to shows or sports events, meals, lodging, rentals, transportation, and gratuities) are unallowable.

15. Equipment and other capital expenditures

a. For purposes of this subsection 15, the following definitions apply:

(1) "Capital Expenditures" means expenditures for the acquisition cost of capital assets (equipment, buildings, land), or expenditures to make improvements to capital assets that materially increase their value or useful life. Acquisition cost means the cost of the asset including the cost to put it in place. Acquisition cost for equipment, for example, means the net invoice price of the equipment, including the cost of any modifications, attachments, accessories, or auxiliary apparatus necessary to make it usable for the purpose for which it is acquired. Ancillary charges, such as taxes, duty, protective in transit insurance, freight, and installation may be included in, or excluded from the acquisition cost in accordance with the governmental unit's regular accounting practices.

(2) "Equipment" means an article of nonexpendable, tangible personal property having a useful life of more than one year and an acquisition cost which equals or exceeds the lesser of the capitalization level established by the governmental unit for financial statement purposes, or \$5000.

(3) "Special purpose equipment" means equipment which is used only for research, medical, scientific, or other technical activities. Examples of special purpose equipment include microscopes, x-ray

machines, surgical instruments, and spectrometers.

(4) "General purpose equipment" means equipment, which is not limited to research, medical, scientific or other technical activities. Examples include office equipment and furnishings, modular offices, telephone networks, information technology equipment and systems, air conditioning equipment, reproduction and printing equipment, and motor vehicles.

b. The following rules of allowability shall apply to equipment and other capital expenditures:

(1) Capital expenditures for general purpose equipment, buildings, and land are unallowable as direct charges, except where approved in advance by the awarding agency.

(2) Capital expenditures for special purpose equipment are allowable as direct costs, provided that items with a unit cost of \$5000 or more have the prior approval of the awarding agency.

(3) Capital expenditures for improvements to land, buildings, or equipment which materially increase their value or useful life are unallowable as a direct cost except with the prior approval of the awarding agency.

(4) When approved as a direct charge pursuant to Attachment B, section 15.b (1), (2), and (3) above, capital expenditures will be charged in the period in which the expenditure is incurred, or as otherwise determined appropriate and negotiated with the awarding agency. In addition, federal awarding agencies are authorized at their option to waive or delegate the prior approval requirement.

(5) Equipment and other capital expenditures are unallowable as indirect costs. However, see section 11, Depreciation and use allowance, for rules on the allowability of use allowances or depreciation on buildings, capital improvements, and equipment. Also, see section 37, Rental costs, concerning the

allowability of rental costs for land, buildings, and equipment.

(6) The unamortized portion of any equipment written off as a result of a change in capitalization levels may be recovered by continuing to claim the otherwise allowable use allowances or depreciation on the equipment, or by amortizing the amount to be written off over a period of years negotiated with the cognizant agency.

(7) When replacing equipment purchased in whole or in part with federal funds, the governmental unit may use the equipment to be replaced as a trade-in or sell the property and use the proceeds to offset the cost of the replacement property.

16. Fines and penalties

Fines, penalties, damages, and other settlements resulting from violations (or alleged violations) of, or failure of the governmental unit to comply with, federal, state, local, or Indian tribal laws and regulations are unallowable except when incurred as a result of compliance with specific provisions of the federal award or written instructions by the awarding agency authorizing in advance such payments.

17. Fund raising and investment management costs

- a. Costs of organized fund raising, including financial campaigns, solicitation of gifts and bequests, and similar expenses incurred to raise capital or obtain contributions are unallowable, regardless of the purpose for which the funds will be used.
- b. Costs of investment counsel and staff and similar expenses incurred to enhance income from investments are unallowable. However, such costs associated with investments covering pension, self insurance, or other funds which include federal participation allowed by this Circular are allowable.

- c. Fund raising and investment activities shall be allocated an appropriate share of indirect costs under the conditions described in subsection C.3.b. of Attachment A.

18. Gains and losses

(on disposition of depreciable property and other capital assets and substantial relocation of federal programs)

- a. (1) Gains and losses on the sale, retirement, or other disposition of depreciable property shall be included in the year in which they occur as credits or charges to the asset cost groupings in which the property was included. The amount of the gain or loss to be included as a credit or charge to the appropriate asset cost groupings shall be the difference between the amount realized on the property and the undepreciated basis of the property.
(2) Gains and losses on the disposition of depreciable property shall not be recognized as a separate credit or charge under the following conditions:
 - (a) The gain or loss is processed through a depreciation account and is reflected in the depreciation allowable under sections 11 and 15.
 - (b) The property is given in exchange as part of the purchase price of a similar item and the gain or loss is taken into account in determining the depreciation cost basis of the new item.
 - (c) A loss results from the failure to maintain permissible insurance, except as otherwise provided in subsection 22.d.
 - (d) Compensation for the use of the property was provided through use allowances in lieu of depreciation.
- b. Substantial relocation of federal awards from a facility where the federal government participated in the financing to another facility prior to the expiration of the useful life of the financed facility requires federal agency approval. The

extent of the relocation, the amount of the federal participation in the financing, and the depreciation charged to date may require negotiation of space charges for federal awards.

- c. Gains or losses of any nature arising from the sale or exchange of property other than the property covered in subsection a., e.g., land or included in the fair market value used in any adjustment resulting from a relocation of federal awards covered in subsection b. shall be excluded in computing federal award costs.

19. General government expenses

- a. The general costs of government are unallowable (except as provided in Attachment B, section 43, Travel costs). These include:

(1) Salaries and expenses of the Office of the Governor of a state or the chief executive of a political subdivision or the chief executive of federally recognized Indian tribal government;

(2) Salaries and other expenses of a state legislature, tribal council, or similar local governmental body, such as a county supervisor, city council, school board, etc., whether incurred for purposes of legislation or executive direction;

(3) Costs of the judiciary branch of a government;

(4) Costs of prosecutorial activities unless treated as a direct cost to a specific program if authorized by program statute or regulation (however, this does not preclude the allowability of other legal activities of the Attorney General); and

(5) Costs of other general types of government services normally provided to the general public, such as fire and police, unless provided for as a direct cost under a program statute or regulation.

- b. For federally recognized Indian tribal governments and Councils Of Governments (COGs), the portion of

salaries and expenses directly attributable to managing and operating federal programs by the chief executive and his staff is allowable.

20. Goods or services for personal use

Costs of goods or services for personal use of the governmental unit's employees are unallowable regardless of whether the cost is reported as taxable income to the employees.

21. Idle facilities and idle capacity

- a. As used in this section the following terms have the meanings set forth below:

(1) "Facilities" means land and buildings or any portion thereof, equipment individually or collectively, or any other tangible capital asset, wherever located, and whether owned or leased by the governmental unit.

(2) "Idle facilities" means completely unused facilities that are excess to the governmental unit's current needs.

(3) "Idle capacity" means the unused capacity of partially used facilities. It is the difference between: (a) that which a facility could achieve under 100 percent operating time on a one-shift basis less operating interruptions resulting from time lost for repairs, setups, unsatisfactory materials, and other normal delays; and (b) the extent to which the facility was actually used to meet demands during the accounting period. A multi-shift basis should be used if it can be shown that this amount of usage would normally be expected for the type of facility involved.

(4) "Cost of idle facilities or idle capacity" means costs such as maintenance, repair, housing, rent, and other related costs, e.g., insurance, interest, property taxes and depreciation or use allowances.

- b. The costs of idle facilities are unallowable except to the extent that:

(1) They are necessary to meet fluctuations in workload; or

(2) Although not necessary to meet fluctuations in workload, they were necessary when acquired and are now idle because of changes in program requirements, efforts to achieve more economical operations, reorganization, termination, or other causes which could not have been reasonably foreseen. Under the exception stated in this subsection, costs of idle facilities are allowable for a reasonable period of time, ordinarily not to exceed one year, depending on the initiative taken to use, lease, or dispose of such facilities.

- c. The costs of idle capacity are normal costs of doing business and are a factor in the normal fluctuations of usage or indirect cost rates from period to period. Such costs are allowable, provided that the capacity is reasonably anticipated to be necessary or was originally reasonable and is not subject to reduction or elimination by use on other federal awards, subletting, renting, or sale, in accordance with sound business, economic, or security practices. Widespread idle capacity throughout an entire facility or among a group of assets having substantially the same function may be considered idle facilities.

22. Insurance and indemnification

- a. Costs of insurance required or approved and maintained, pursuant to the federal award, are allowable.
- b. Costs of other insurance in connection with the general conduct of activities are allowable subject to the following limitations:

(1) Types and extent and cost of coverage are in accordance with the governmental unit's policy and sound business practice.

(2) Costs of insurance or of contributions to any reserve covering the risk of loss of, or damage to, federal government property are unallowable except to the extent that the awarding agency has specifically required or approved such costs.

- c. Actual losses which could have been covered by permissible insurance (through a self insurance program or otherwise) are unallowable, unless expressly provided for in the federal award or as described below. However, the federal government will participate in actual losses of a self insurance fund that are in excess of reserves. Costs incurred because of losses not covered under nominal deductible insurance coverage provided in keeping with sound management practice, and minor losses not covered by insurance, such as spoilage, breakage, and disappearance of small hand tools, which occur in the ordinary course of operations, are allowable.
- d. Contributions to a reserve for certain self insurance programs including workers compensation, unemployment compensation, and severance pay are allowable subject to the following provisions:

(1) The type of coverage and the extent of coverage and the rates and premiums would have been allowed had insurance (including reinsurance) been purchased to cover the risks. However, provision for known or reasonably estimated self insured liabilities, which do not become payable for more than one year after the provision is made, shall not exceed the discounted present value of the liability. The rate used for discounting the liability must be determined by giving consideration to such factors as the governmental unit's settlement rate for those liabilities and its investment rate of return.

(2) Earnings or investment income on reserves must be credited to those reserves.

(3) Contributions to reserves must be based on sound actuarial principles using historical experience and reasonable assumptions. Reserve levels must be analyzed and updated at least biennially for each major risk being insured and take into account any reinsurance, coinsurance, etc. Reserve

levels related to employee related coverages will normally be limited to the value of claims (a) submitted and adjudicated but not paid, (b) submitted but not adjudicated, and (c) incurred but not submitted. Reserve levels in excess of the amounts based on the above must be identified and justified in the cost allocation plan or indirect cost rate proposal.

(4) Accounting records, actuarial studies, and cost allocations (or billings) must recognize any significant differences due to types of insured risk and losses generated by the various insured activities or agencies of the governmental unit. If individual departments or agencies of the governmental unit experience significantly different levels of claims for a particular risk, those differences are to be recognized by the use of separate allocations or other techniques resulting in an equitable allocation.

(5) Whenever funds are transferred from a self insurance reserve to other accounts (e.g., general fund), refunds shall be made to the federal government for its share of funds transferred, including earned or imputed interest from the date of transfer.

- e. Actual claims paid to or on behalf of employees or former employees for workers' compensation, unemployment compensation, severance pay, and similar employee benefits (e.g., subsection 8.f. for post retirement health benefits), are allowable in the year of payment provided (1) the governmental unit follows a consistent costing policy and (2) they are allocated as a general administrative expense to all activities of the governmental unit.
- f. Insurance refunds shall be credited against insurance costs in the year the refund is received.
- g. Indemnification includes securing the governmental unit against liabilities to third persons and other losses not compensated by insurance or otherwise. The federal government is obligated to

indemnify the governmental unit only to the extent expressly provided for in the federal award, except as provided in subsection d.

- h. Costs of commercial insurance that protects against the costs of the contractor for correction of the contractor's own defects in materials or workmanship are unallowable.

23. Interest

- a. Costs incurred for interest on borrowed capital or the use of a governmental unit's own funds, however represented, are unallowable except as specifically provided in subsection b. or authorized by federal legislation.
- b. Financing costs (including interest) paid or incurred which are associated with the otherwise allowable costs of building acquisition, construction, or fabrication, reconstruction or remodeling completed on or after October 1, 1980 is allowable subject to the conditions in (1) through (4) of this section 23.b. Financing costs (including interest) paid or incurred on or after September 1, 1995 for land or associated with otherwise allowable costs of equipment is allowable, subject to the conditions in (1) through (4).

(1) The financing is provided (from other than tax or user fee sources) by a bona fide third party external to the governmental unit;

(2) These assets are used in support of federal awards;

(3) Earnings on debt service reserve funds or interest earned on borrowed funds pending payment of the construction or acquisition costs are used to offset the current period's cost or the capitalized interest, as appropriate. Earnings subject to being reported to the federal Internal Revenue Service under arbitrage requirements are excludable.

(4) For debt arrangements over \$1 million, unless the governmental unit makes an initial equity contribution to the asset

purchase of 25 percent or more, the governmental unit shall reduce claims for interest cost by an amount equal to imputed interest earnings on excess cash flow, which is to be calculated as follows. Annually, non-federal entities shall prepare a cumulative (from the inception of the project) report of monthly cash flows that includes inflows and outflows, regardless of the funding source. Inflows consist of depreciation expense, amortization of capitalized construction interest, and annual interest cost. For cash flow calculations, the annual inflow figures shall be divided by the number of months in the year (i.e., usually 12) that the building is in service for monthly amounts. Outflows consist of initial equity contributions, debt principal payments (less the pro rata share attributable to the unallowable costs of land) and interest payments. Where cumulative inflows exceed cumulative outflows, interest shall be calculated on the excess inflows for that period and be treated as a reduction to allowable interest cost. The rate of interest to be used to compute earnings on excess cash flows shall be the three-month Treasury bill closing rate as of the last business day of that month.

(5) Interest attributable to fully depreciated assets is unallowable.

24. Lobbying

- a. General. The cost of certain influencing activities associated with obtaining grants, contracts, cooperative agreements, or loans is an unallowable cost. Lobbying with respect to certain grants, contracts, cooperative agreements, and loans shall be governed by the common rule, "New Restrictions on Lobbying" published at 55 FR 6736 (February 26, 1990), including definitions, and the Office of Management and Budget "Government wide Guidance for New Restrictions on Lobbying" and notices published at 54 FR 52306 (December 20, 1989), 55 FR 24540 (June 15, 1990), and 57 FR 1772 (January 15, 1992), respectively.

- b. Executive lobbying costs. Costs incurred in attempting to improperly influence either directly or indirectly, an employee or officer of the Executive Branch of the federal government to give consideration or to act regarding a sponsored agreement or a regulatory matter are unallowable. Improper influence means any influence that induces or tends to induce a federal employee or officer to give consideration or to act regarding a federally sponsored agreement or regulatory matter on any basis other than the merits of the matter.

25. Maintenance, operations, and repairs

Unless prohibited by law, the cost of utilities, insurance, security, janitorial services, elevator service, upkeep of grounds, necessary maintenance, normal repairs and alterations, and the like are allowable to the extent that they: (1) keep property (including federal property, unless otherwise provided for) in an efficient operating condition, (2) do not add to the permanent value of property or appreciably prolong its intended life, and (3) are not otherwise included in rental or other charges for space. Costs which add to the permanent value of property or appreciably prolong its intended life shall be treated as capital expenditures (see sections 11 and 15).

26. Materials and supplies costs

- a. Costs incurred for materials, supplies, and fabricated parts necessary to carry out a federal award are allowable.
- b. Purchased materials and supplies shall be charged at their actual prices, net of applicable credits. Withdrawals from general stores or stockrooms should be charged at their actual net cost under any recognized method of pricing inventory withdrawals, consistently applied. Incoming transportation charges are a proper part of materials and supplies costs.

- c. Only materials and supplies actually used for the performance of a federal award may be charged as direct costs.
- d. Where federally donated or furnished materials are used in performing the federal award, such materials will be used without charge.

27. Meetings and conferences

Costs of meetings and conferences, the primary purpose of which is the dissemination of technical information, are allowable. This includes costs of meals, transportation, rental of facilities, speakers' fees, and other items incidental to such meetings or conferences. But see Attachment B, section 14, Entertainment costs.

28. Memberships, subscriptions, and professional activity costs

- a. Costs of the governmental unit's memberships in business, technical, and professional organizations are allowable.
- b. Costs of the governmental unit's subscriptions to business, professional, and technical periodicals are allowable.
- c. Costs of membership in civic and community, social organizations are allowable as a direct cost with the approval of the federal awarding agency.
- d. Costs of membership in organizations substantially engaged in lobbying are unallowable.

29. Patent costs

- a. The following costs relating to patent and copyright matters are allowable:
 - (i) cost of preparing disclosures, reports, and other documents required by the federal award and of searching the art to the extent necessary to make such disclosures;
 - (ii) cost of preparing documents and any other patent costs in connection with the filing and prosecution of a United States

patent application where title or royalty-free license is required by the federal government to be conveyed to the federal government; and

(iii) general counseling services relating to patent and copyright matters, such as advice on patent and copyright laws, regulations, clauses, and employee agreements (but see Attachment B, sections 32, Professional service costs, and 38, Royalties and other costs for use of patents and copyrights).

- b. The following costs related to patent and copyright matter are unallowable:

(i) Cost of preparing disclosures, reports, and other documents and of searching the art to the extent necessary to make disclosures not required by the award

(ii) Costs in connection with filing and prosecuting any foreign patent application, or (ii) any United States patent application, where the federal award does not require conveying title or a royalty-free license to the federal government (but see Attachment B, section 38., Royalties and other costs for use of patents and copyrights).

30. Plant and homeland security costs

Necessary and reasonable expenses incurred for routine and homeland security to protect facilities, personnel, and work products are allowable. Such costs include, but are not limited to, wages and uniforms of personnel engaged in security activities; equipment; barriers; contractual security services; consultants; etc. Capital expenditures for homeland and plant security purposes are subject to section 15., Equipment and other capital expenditures, of this Circular.

31. Pre award costs

Pre award costs are those incurred prior to the effective date of the award directly pursuant to the negotiation and in anticipation of the award where such costs are necessary to comply with the proposed delivery schedule or period of performance.

Such costs are allowable only to the extent that they would have been allowable if incurred after the date of the award and only with the written approval of the awarding agency.

32. Professional service costs

- a. Costs of professional and consultant services rendered by persons who are members of a particular profession or possess a special skill, and who are not officers or employees of the governmental unit, are allowable, subject to subparagraphs b and c when reasonable in relation to the services rendered and when not contingent upon recovery of the costs from the federal government.

In addition, legal and related services are limited under Attachment B, section 10.

- b. In determining the allowability of costs in a particular case, no single factor or any special combination of factors is necessarily determinative. However, the following factors are relevant:

- (1) The nature and scope of the service rendered in relation to the service required.
- (2) The necessity of contracting for the service, considering the governmental unit's capability in the particular area.
- (3) The past pattern of such costs, particularly in the years prior to federal awards.
- (4) The impact of federal awards on the governmental unit's business (i.e., what new problems have arisen).
- (5) Whether the proportion of federal work to the governmental unit's total business is such as to influence the governmental unit in favor of incurring the cost, particularly where the services rendered are not of a continuing nature and have little relationship to work under federal grants and contracts.
- (6) Whether the service can be performed more economically by direct employment rather than contracting.

- (7) The qualifications of the individual or concern rendering the service and the customary fees charged, especially on non-federal awards.

- (8) Adequacy of the contractual agreement for the service (e.g., description of the service, estimate of time required, rate of compensation, and termination provisions).

- c. In addition to the factors in subparagraph b, retainer fees to be allowable must be supported by available or rendered evidence of bona fide services available or rendered.

33. Proposal costs

Costs of preparing proposals for potential federal awards are allowable. Proposal costs should normally be treated as indirect costs and should be allocated to all activities of the governmental unit utilizing the cost allocation plan and indirect cost rate proposal. However, proposal costs may be charged directly to federal awards with the prior approval of the federal awarding agency.

34. Publication and printing costs

- a. Publication costs include the costs of printing (including the processes of composition, plate-making, press work, binding, and the end products produced by such processes), distribution, promotion, mailing, and general handling. Publication costs also include page charges in professional publications.
- b. If these costs are not identifiable with a particular cost objective, they should be allocated as indirect costs to all benefiting activities of the governmental unit.
- c. Page charges for professional journal publications are allowable as a necessary part of research costs where:

- (1) The research papers report work supported by the federal government: and

(2) The charges are levied impartially on all research papers published by the journal, whether or not by federally sponsored authors

35. Rearrangement and alteration costs

Costs incurred for ordinary and normal rearrangement and alteration of facilities are allowable. Special arrangements and alterations costs incurred specifically for a federal award are allowable with the prior approval of the federal awarding agency.

36. Reconversion costs

Costs incurred in the restoration or rehabilitation of the governmental unit's facilities to approximately the same condition existing immediately prior to commencement of federal awards, less costs related to normal wear and tear, are allowable.

37. Rental costs of buildings and equipment

- a. Subject to the limitations described in subsections b. through d. of this section, rental costs are allowable to the extent that the rates are reasonable in light of such factors as: rental costs of comparable property, if any; market conditions in the area; alternatives available; and, the type, life expectancy, condition, and value of the property leased. Rental arrangements should be reviewed periodically to determine if circumstances have changed and other options are available.
- b. Rental costs under "sale and lease back" arrangements are allowable only up to the amount that would be allowed had the governmental unit continued to own the property. This amount would include expenses such as depreciation or use allowance, maintenance, taxes, and insurance.
- c. Rental costs under "less-than-arms-length" leases are allowable only up to the amount (as explained in Attachment B, section 37.b) that would be allowed

had title to the property vested in the governmental unit. For this purpose, a less-than-arms-length lease is one under which one party to the lease agreement is able to control or substantially influence the actions of the other. Such leases include, but are not limited to those between (i) divisions of a governmental unit; (ii) governmental units under common control through common officers, directors, or members; and (iii) a governmental unit and a director, trustee, officer, or key employee of the governmental unit or his immediate family, either directly or through corporations, trusts, or similar arrangements in which they hold a controlling interest. For example, a governmental unit may establish a separate corporation for the sole purpose of owning property and leasing it back to the governmental unit.

- d. Rental costs under leases which are required to be treated as capital leases under GAAP are allowable only up to the amount (as explained in subsection b) that would be allowed had the governmental unit purchased the property on the date the lease agreement was executed. The provisions of Financial Accounting Standards Board Statement 13, Accounting for Leases, shall be used to determine whether a lease is a capital lease. Interest costs related to capital leases are allowable to the extent they meet the criteria in Attachment B, section 23. Unallowable costs include amounts paid for profit, management fees, and taxes that would not have been incurred had the governmental unit purchased the facility.

38. Royalties and other costs for the use of patents

- a. Royalties on a patent or copyright or amortization of the cost of acquiring by purchase a copyright, patent, or rights thereto, necessary for the proper

performance of the award are allowable unless:

(1) The federal government has a license or the right to free use of the patent or copyright.

(2) The patent or copyright has been adjudicated to be invalid, or has been administratively determined to be invalid.

(3) The patent or copyright is considered to be unenforceable.

(4) The patent or copyright is expired.

b. Special care should be exercised in determining reasonableness where the royalties may have been arrived at as a result of less-than-arm's-length bargaining, e.g.:

(1) Royalties paid to persons, including corporations, affiliated with the governmental unit.

(2) Royalties paid to unaffiliated parties, including corporations, under an agreement entered into in contemplation that a federal award would be made.

(3) Royalties paid under an agreement entered into after an award is made to a governmental unit.

c. In any case involving a patent or copyright formerly owned by the governmental unit, the amount of royalty allowed should not exceed the cost which would have been allowed had the governmental unit retained title thereto.

39. Selling and marketing

Costs of selling and marketing any products or services of the governmental unit are unallowable (unless allowed under Attachment B, section 1. as allowable public relations costs or under Attachment B, section 33. as allowable proposal costs.

40. Taxes

a. Taxes that a governmental unit is legally required to pay are allowable, except for self assessed taxes that disproportionately affect federal

programs or changes in tax policies that disproportionately affect federal programs. This provision becomes effective for taxes paid during the governmental unit's first fiscal year that begins on or after January 1, 1998, and applies thereafter.

b. Gasoline taxes, motor vehicle fees, and other taxes that are in effect user fees for benefits provided to the federal government are allowable.

c. This provision does not restrict the authority of federal agencies to identify taxes where federal participation is inappropriate. Where the identification of the amount of unallowable taxes would require an inordinate amount of effort, the cognizant agency may accept a reasonable approximation thereof.

41. Termination costs applicable to sponsored agreements

Termination of awards generally gives rise to the incurrence of costs, or the need for special treatment of costs, which would not have arisen had the federal award not been terminated. Cost principles covering these items are set forth below. They are to be used in conjunction with the other provisions of this Circular in termination situations.

a. The cost of items reasonably usable on the governmental unit's other work shall not be allowable unless the governmental unit submits evidence that it would not retain such items at cost without sustaining a loss. In deciding whether such items are reasonably usable on other work of the governmental unit, the awarding agency should consider the governmental unit's plans and orders for current and scheduled activity.

Contemporaneous purchases of common items by the governmental unit shall be regarded as evidence that such items are reasonably usable on the governmental unit's other work. Any acceptance of common items as allocable to the

terminated portion of the federal award shall be limited to the extent that the quantities of such items on hand, in transit, and on order are in excess of the reasonable quantitative requirements of other work.

- b. If in a particular case, despite all reasonable efforts by the governmental unit, certain costs cannot be discontinued immediately after the effective date of termination, such costs are generally allowable within the limitations set forth in this Circular, except that any such costs continuing after termination due to the negligent or willful failure of the governmental unit to discontinue such costs shall be unallowable.
- c. Loss of useful value of special tooling, machinery, and equipment is generally allowable if:
 - (1) Such special tooling, special machinery, or equipment is not reasonably capable of use in the other work of the governmental unit,
 - (2) The interest of the federal government is protected by transfer of title or by other means deemed appropriate by the awarding agency, and
 - (3) The loss of useful value for any one terminated federal award is limited to that portion of the acquisition cost which bears the same ratio to the total acquisition cost as the terminated portion of the federal award bears to the entire terminated federal award and other federal awards for which the special tooling, machinery, or equipment was acquired.
- d. Rental costs under unexpired leases are generally allowable where clearly shown to have been reasonably necessary for the performance of the terminated federal award less the residual value of such leases, if:
 - (1) the amount of such rental claimed does not exceed the reasonable use value of the property leased for the period of the federal

award and such further period as may be reasonable, and

(2) the governmental unit makes all reasonable efforts to terminate, assign, settle, or otherwise reduce the cost of such lease. There also may be included the cost of alterations of such leased property, provided such alterations were necessary for the performance of the federal award, and of reasonable restoration required by the provisions of the lease.

e. Settlement expenses including the following are generally allowable:

(1) Accounting, legal, clerical, and similar costs reasonably necessary for:

(a) The preparation and presentation to the awarding agency of settlement claims and supporting data with respect to the terminated portion of the federal award, unless the termination is for default (see Subpart __.44 of the Grants Management Common Rule implementing OMB Circular A-102); and

(b) The termination and settlement of subawards.

(2) Reasonable costs for the storage, transportation, protection, and disposition of property provided by the federal government or acquired or produced for the federal award, except when grantees or contractors are reimbursed for disposals at a predetermined amount in accordance with Subparts __.31 and __.32 of the Grants Management Common Rule implementing OMB Circular A-102.

f. Claims under subawards, including the allocable portion of claims which are common to the federal award, and to other work of the governmental unit are generally allowable.

An appropriate share of the governmental unit's indirect expense may be allocated to the amount of settlements with subcontractors and/or subgrantees, provided that the amount allocated is otherwise consistent with the basic guidelines contained in Attachment A. The

indirect expense so allocated shall exclude the same and similar costs claimed directly or indirectly as settlement expenses.

42. Training costs

The cost of training provided for employee development is allowable.

43. Travel costs

- a. General. Travel costs are the expenses for transportation, lodging, subsistence, and related items incurred by employees who are in travel status on official business of the governmental unit. Such costs may be charged on an actual cost basis, on a per diem or mileage basis in lieu of actual costs incurred, or on a combination of the two, provided the method used is applied to an entire trip and not to selected days of the trip, and results in charges consistent with those normally allowed in like circumstances in the governmental unit's non-federally sponsored activities. Notwithstanding the provisions of Attachment B, section 19, General government expenses, travel costs of officials covered by that section are allowable with the prior approval of an awarding agency when they are specifically related to federal awards.
- b. Lodging and subsistence. Costs incurred by employees and officers for travel, including costs of lodging, other subsistence, and incidental expenses, shall be considered reasonable and allowable only to the extent such costs do not exceed charges normally allowed by the governmental unit in its regular operations as the result of the governmental unit's written travel policy. In the absence of an acceptable, written governmental unit policy regarding travel costs, the rates and amounts established under subchapter I of Chapter 57, Title 5, United States Code ("Travel and Subsistence Expenses; Mileage Allowances"), or by the

Administrator of General Services, or by the President (or his or her designee) pursuant to any provisions of such subchapter shall apply to travel under federal awards (48 CFR 31.205-46(a)).

c. Commercial air travel.

(1) Airfare costs in excess of the customary standard commercial airfare (coach or equivalent), federal government contract airfare (where authorized and available), or the lowest commercial discount airfare are unallowable except when such accommodations would:

- (a) require circuitous routing;
- (b) require travel during unreasonable hours;
- (c) excessively prolong travel;
- (d) result in additional costs that would offset the transportation savings; or
- (e) offer accommodations not reasonably adequate for the traveler's medical needs. The governmental unit must justify and document these conditions on a case-by-case basis in order for the use of first-class airfare to be allowable in such cases.

(2) Unless a pattern of avoidance is detected, the federal government will generally not question a governmental unit's determinations that customary standard airfare or other discount airfare is unavailable for specific trips if the governmental unit can demonstrate either of the following: (a) that such airfare was not available in the specific case; or (b) that it is the governmental unit's overall practice to make routine use of such airfare.

- d. Air travel by other than commercial carrier. Costs of travel by governmental unit-owned, -leased, or -chartered aircraft include the cost of lease, charter, operation (including personnel costs), maintenance, depreciation, insurance, and other related costs. The portion of such costs that exceeds the cost of allowable commercial air travel,

as provided for in subsection c., is unallowable.

- e. Foreign travel. Direct charges for foreign travel costs are allowable only when the travel has received prior approval of the awarding agency. Each separate foreign trip must receive such approval. For purposes of this provision, "foreign travel" includes any travel outside Canada, Mexico, the United States, and any United States territories and possessions. However, the term "foreign travel" for a governmental unit located in a foreign country means travel outside that country.

OMB Circular A-133

§ __.210 Subrecipient and vendor determinations.

(a) **General.** An auditee may be a recipient, a subrecipient, and a vendor. Federal awards expended as a recipient or a subrecipient would be subject to audit under this part. The payments received for goods or services provided as a vendor would not be considered federal awards. The guidance in paragraphs (b) and (c) of this section should be considered in determining whether payments constitute a federal award or a payment for goods and services.

(b) **Federal award.** Characteristics indicative of a federal award received by a subrecipient are when the organization:

- (1) Determines who is eligible to receive what federal financial assistance;
- (2) Has its performance measured against whether the objectives of the federal program are met;
- (3) Has responsibility for programmatic decision making;
- (4) Has responsibility for adherence to applicable federal program compliance requirements; and
- (5) Uses the federal funds to carry out a program of the organization as compared to

providing goods or services for a program of the pass-through entity.

(c) Payment for goods and services.

Characteristics indicative of a payment for goods and services received by a vendor are when the organization:

- (1) Provides the goods and services within normal business operations;
- (2) Provides similar goods or services to many different purchasers;
- (3) Operates in a competitive environment;
- (4) Provides goods or services that are ancillary to the operation of the federal program; and
- (5) Is not subject to compliance requirements of the federal program.

(d) Use of judgment in making determination.

There may be unusual circumstances or exceptions to the listed characteristics. In making the determination of whether a subrecipient or vendor relationship exists, the substance of the relationship is more important than the form of the agreement. It is not expected that all of the characteristics will be present and judgment should be used in determining whether an entity is a subrecipient or vendor.

(e) **For-profit subrecipient.** Since this part does not apply to for-profit subrecipients, the pass-through entity is responsible for establishing requirements, as necessary, to ensure compliance by for-profit subrecipients. The contract with the for-profit subrecipient should describe applicable compliance requirements and the for-profit subrecipient's compliance responsibility. Methods to ensure compliance for federal awards made to for-profit subrecipients may include pre-award audits, monitoring during the contract, and post-award audits.

(f) Compliance responsibility for vendors. In most cases, the auditee's compliance responsibility for vendors is only to ensure that the procurement, receipt, and payment

for goods and services comply with laws, regulations, and the provisions of contracts or grant agreements. Program compliance requirements normally do not pass through to vendors. However, the auditee is responsible for ensuring compliance for vendor transactions which are structured such that the vendor is responsible for program compliance or the vendor's records must be reviewed to determine program compliance. Also, when these vendor transactions relate to a major program, the scope of the audit shall include determining whether these transactions are in compliance with laws, regulations, and the provisions of contracts or grant agreements.

USDA: Indirect Cost Guide

Appendix 1, Step 2: Remove All Excluded Costs

The next step is to exclude all costs that would distort the final result. "Distorting items" should be excluded because they do not generate or benefit from the administrative overhead in the same manner as wages, salaries, etc. Distorting items include (but are not limited to):

Food costs in the school food service.

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