

# Using federal grant funds to recover 'Indirect Costs'

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## The “Cost” of Doing Business

Many federal education grants are made available to sub-recipients to meet the needs of students who require additional assistance, and the funds are often earmarked for specific student populations and activities. In order to claim these funds, the sub-recipient must comply with the requirements of the grant and implement activities that support the grant goals. These activities are often referred to as “direct costs” – an expenditure that exists because of the need to meet the grant requirements. A teacher that provides reading instruction to Title I eligible students in a Title I targeted assistance school is a direct cost of the Title I grant program. If the school did not have a Title I grant program, the district may not have employed this instructor – she is a cost generated by the requirements of the Title I grant. However, the Title I teacher does not work in a vacuum. There is a principal who supervises the teacher, business office staff who run payroll for the teacher, and human resources that provide services for all staff. These additional costs generated by the Title I teacher are indirectly related to the implementation of the grant.

Acknowledging that a grant project incurs costs indirectly related to implementing the work, the federal government created a system by which a sub-recipient can determine its ‘cost of doing business’ and recover that amount from certain federal grants. Depending on the federal grant type, a sub-recipient with an established indirect rate can apply a percentage against the federal grant to recover funds to offset its operating costs. This process for recovering funds for indirect costs is covered in Appendix VII of 2 CFR 200 (Uniform Grant Guidance), *States and Local Government and Indian Tribe Indirect Cost Proposals*.

## Direct Costs versus Indirect Costs

All federal grant programs identify costs that may be funded with the grant. These are referred to as “allowable” costs and are specific to each grant program. Allowable costs are identified as either direct costs or indirect costs.

Direct costs are the actual expenditures generated by conducting the activities that support the grant purpose. Examples of direct costs include the salary and benefits of employees, travel, professional development, equipment, and contracted services directly related to the grant activities. Indirect costs are expenses incurred that cannot be credited to an individual project or activity, but are necessary for the general operation of all the sub-recipient’s activities. Examples of indirect costs include payroll, human resources, administration, and IT support.

Certain indirect costs may be categorized as direct depending on how they are tracked. If a bookkeeper can demonstrate through time and effort reporting the portion of time spent working on a particular grant, this may be considered a direct cost. However, if the bookkeeper works on many different programs, and does not determine time spent for each project, this is considered a service incurred for the benefit of all the sub-recipient’s activities and categorized as an indirect cost.

Additionally, direct costs may also include general supplies, photocopying, printing, postage, and communication (phone) *if* the sub-recipient can tie actual costs back to the grant project. For example, if staff use a department code when making photocopies, the sub-recipient can match actual costs to the grant program. However, if staff do not identify their department when using the phone system, then the actual communication cost for the project cannot be determined and cannot be charged as a direct cost.

### How Indirect Cost Rates are Determined

Each year in Wisconsin, DPI’s School Financial Services team establishes two indirect rates for LEAs (this process currently does not include independent charter schools because independent charter schools do not submit PI-1505 annual reports to DPI) based on financial data collected from the PI-1505 annual reports. These indirect rates apply to all federal grant programs. Each LEA is given a “restricted” and “unrestricted” indirect rate. The restricted rate is much lower than the unrestricted rate and must be used for by federal grants awarded by the US Department of Education that have a supplement not supplant provision, per its requirement in 34 CFR §76.563. In addition, some federal programs further restrict the amount of grant funds that can be recovered through indirect (Titles II and III).

An LEA’s indirect rate is based on audited financial data. Because the data must be audited, the figures used to determine the rate are from the second preceding fiscal year. For example, the indirect rate established for FY 2016-17 is based on financial data submitted for FY 2014-15. The rate is calculated by taking the total of allowed indirect costs (per 2 CFR 200, Appendix VII) divided by the direct cost base. As an example, if the total of FY 2014-15 indirect costs equaled \$50,000 and the total direct cost base for that year was \$800,000, the LEA’s restricted indirect rate for FY 2016-17 would be 6.25 percent ( $\$50,000 / \$800,000 = 6.25\%$ )

The costs that are considered **indirect** for the purpose of determining the indirect rate are functions in Fund 10 which cover the district’s business operations, financial and property accounting, payroll, inventory control, internal auditing, and information technology services (it does not include utilities):

251 000 Direction of Business	252 000 Fiscal
259 000 Other Business Administration	260 000 Central Services

The costs that are considered **direct** for the purpose of determining the indirect rate are the following functions in funds 10, 20, 50, 72, 80 and 90:

100 000 Instruction	210 000 Support Services - Pupils
220 000 Support Services - Instructional Staff	230 000 Support Services - General Admin
240 000 Support Services - School Bldg Admin	255 000 Support Services - Facilities
256 000 Support Services - Transportation	258 000 Support Services - Internal Services
270 000 Support Services - Insurance	290 000 Support services - Other Support
430 000 General Tuition Payments	

The costs pulled from the functions above generally include wages, benefits, and other direct costs but exclude such things as capital equipment purchases, retirement and termination payments.

The School Financial Services team provides a more in-depth [recorded overview](#) of how indirect rates, both restricted and unrestricted, are calculated. This overview was recorded in 2008 and does not address the web-based budgeting system that now exists for ESEA and IDEA formula grants.

The restricted and unrestricted rates for all LEAs are posted at [dpi.wi.gov/sfs/aid/federal/indirect-costs](http://dpi.wi.gov/sfs/aid/federal/indirect-costs).

### Adjustments to Increase an Indirect Rate

DPI determines an indirect rate based on audited financial data pulled from very high-level functions. This may result in costs that would qualify as indirect being pulled into the direct cost base. In turn, this lowers an LEA's indirect rate. All LEAs have the option of submitting an Indirect Rate Adjustment that would notify DPI of costs that should be included in the allowed indirect pool rather than the direct cost base. Audit costs are an example of an 'allowed indirect' that, due to the function, is pulled into the direct cost base. Here's an example of how this adjustment affects the indirect rate:

FY 15 Exp that qualify as "Indirect"		FY 15 Exp that qualify as "Direct"		Function 230 000 includes principal salaries (which are direct costs) but it also includes audit costs (231 700), which are an indirect cost. But, function 231 700 gets pulled in as part of the direct cost pool, lowering the indirect rate available, <b>unless</b> the LEA requests an adjustment from DPI.
251 000	\$10,000	100 000	\$500,000	
252 000	\$10,000	256 000	\$100,000	
259 000	\$10,000	230 000	\$200,000	
260 000	\$10,000	258 000	\$100,000	
<b>Total:</b>	<b>\$40,000</b>	<b>Total:</b>	<b>\$900,000</b>	
				<b>FY 17 Indirect Rate without adjustments</b>
				<b>4.4%</b>

Possible Adjustment (if requested by the LEA)

FY 15 Exp that qualify as "Indirect"		FY 15 Exp that qualify as "Direct"		Requested Adjustment to Indirect for 230 000	Requested Adjustment to Direct for 230 000
251 000	\$10,000	100 000	\$500,000		
252 000	\$10,000	256 000	\$100,000		
230 000	\$20,000	230 000	\$180,000	+ \$20,000	(\$20,000)
259 000	\$10,000				
260 000	\$10,000	258 000	\$100,000	<b>FY 17 Indirect Rate WITH adjustments</b>	
<b>Adjusted:</b>	<b>\$60,000</b>	<b>Adjusted</b>	<b>\$880,000</b>	<b>6.8%</b>	

Adjustments are also based on audited expenditure data from the year that determines the current year rate. In the example above, the indirect rate is for FY 2016-17, but the expenditure data being used, including the adjustment, is from FY 2014-15.

Functions pulled into the direct cost base that would qualify as indirect include:

230 700	Audit	270 000	Property Insurance
258 200	Purchasing	231 500	Legal
270 000	Liability Insurance	217 000	Attendance

To request an adjustment, the LEA must complete DPI form PI-1161 at [dpi.wi.gov/sfs/aid/federal/indirect-costs](http://dpi.wi.gov/sfs/aid/federal/indirect-costs). Adjustments for an indirect rate are usually due by the end of November.

### Funding Indirect Costs

There is a misconception that federal funds recovered through the indirect rate are tied to a specific cost. This is only true of direct costs (such as a teacher’s salary) charged to the grant. Indirect costs that may be related to the project are used to compute the LEA’s indirect rate, but are not individually reimbursed by the federal grant. Funds recovered by applying the indirect rate are coded as revenue but not tied to a particular expenditure. This can be confusing when a statement is made that a “cost is allowable under the federal grant, but is covered by indirect,” which implies that there is an expenditure and a revenue. What is actually meant is the cost in question can be included as part of the allowed indirect base when calculating an LEA’s indirect rate. This may result in a higher indirect rate so the eventual amount recovered lowers the LEA’s overall general costs.

### Required Adjustments to the Indirect Rate Calculation when an Indirect Cost is Charged as a Direct Cost

Just as an adjustment can be requested to increase an indirect rate by moving costs from the direct cost base to the indirect cost pool, LEAs that charge functions that are pulled into the indirect cost pool as direct costs on a grant must report the cost through the indirect rate adjustment process. A bookkeeper’s salary is recorded in 252 000, a function that is pulled in as an indirect cost when calculating the indirect rate. The bookkeeper’s salary may also be charged to a grant (if allowed) as a direct line item if the individual is maintaining appropriate [supporting documentation](#). In this situation, the bookkeeper’s salary is being recorded as both a direct and indirect cost. If the LEA plans to claim indirect recovery, the LEA is required to report an adjustment and subtract the amount of costs charged to the federal grant from the indirect cost pool. Below is an example of how this adjustment affects the indirect rate:

FY 15 Exp that qualify as “Indirect”		FY 15 Exp that qualify as “Direct”		
252 000	\$40,000	100 000	\$500,000	
260 000	\$10,000	258 000	\$100,000	<b>FY 17 Indirect Rate without adjustments</b>
<b>Total:</b>	<b>\$50,000</b>	<b>Total:</b>	<b>\$600,000</b>	<b>8.3%</b>

Amount of the bookkeeper’s salary and benefits charged to the IDEA grant as a direct cost

FY 15 Exp that qualify as “Indirect”		FY 15 Exp that qualify as “Direct”		Requested Adjustment to Indirect for 252 000	Requested Adjustment to Direct for 252 000
252 000	\$25,000	252 000	\$15,000	(\$15,000)	+\$15,000
		100 000	\$500,000		
260 000	\$10,000	258 000	\$100,000	<b>FY 17 Indirect Rate WITH adjustments</b>	
<b>Adjusted:</b>	<b>\$35,000</b>	<b>Adjusted</b>	<b>\$615,000</b>	<b>5.7%</b>	

### Coding Indirect Recovery

*The following instructions pertain to all federal grants except for IDEA flow-through and preschool, which must reflect a transfer from fund 27 to fund 10. See [Indirect Recovery Budget / Claim Instructions for IDEA](#) for further instructions.*

If an LEA chooses to budget and claim indirect cost recovery, the coding is simple: there is none. In cases where indirect is recovered, the sub-recipient will have a disparity between expenditures identified as grant funded (by the use of the project code) and the revenue received from the grant funding source - the difference reflects the indirect amount recovered. For example, an LEA will book \$100,000 in project 141 (Title I-A) expenditures in fund 10 and \$105,000 in source 751. The \$5,000 difference between expenditures and revenue is the amount of indirect recovery the LEA received through the Title I-A grant.

### Indirect Recovery Budget / Claim Instructions per Federal Grant Program:

Title I-A formula grants: <http://dpi.wi.gov/sites/default/files/imce/wisegrants/pdf/indirect-title-I.pdf>

IDEA entitlement grants: <http://dpi.wi.gov/sites/default/files/imce/wisegrants/pdf/indirect-idea.pdf>

Title II-A formula grants: <http://dpi.wi.gov/sites/default/files/imce/wisegrants/pdf/indirect-title-II.pdf>

Title III-A formula grants: <http://dpi.wi.gov/sites/default/files/imce/wisegrants/pdf/indirect-title-III.pdf>