

**COMMUNITY SERVICES BLOCK  
GRANT PROGRAM**

U.S. Department of  
Health and Human Services  
Administration for Children and Families  
Office of Community Services  
Division of State Assistance  
370 L'Enfant Promenade, S.W.  
Washington, D.C. 20447

**Information Memorandum**

**Transmittal No. 20**

**Date April 23, 1997**

**TO:** State Community Services Block Grant Directors, State Comptrollers, U.S. Territories, Community Action Agencies, Native American Tribes and Tribal Organizations, Community Development Corporations and other Non-profit Organizations receiving Community Services Block Grant (CSBG) funds.

**SUBJECT:** A discussion of Indirect Cost Rate Principles

**RELATED  
REFERENCES:**

Public Law 97-35, Omnibus Budget Reconciliation Act of 1981; as amended; P.L. 103-252, Human Services Amendments of 1994; P.L. 104.134, the FY 1996 CSBG Appropriation Legislation; C.F.R. Title 45, Part 96, Department of Health and Human Services Block Grant Regulations, OMB Circular A-128 and A-133.

**PURPOSE:** This Informational Memorandum is to inform States, U.S. Territories, Community Action Agencies (CAAs), Native American Tribes and Tribal Organizations, Community Development Corporations and other Non-profit Organizations of the need to establish an indirect cost rate for all eligible entities.

**APPLICATION  
REQUIREMENTS:**

Many agencies operating programs funded directly by Federal agencies or with flow-through funds from State agencies do not use an indirect cost rate for recovering eligible costs. As a result, these organizations recover such costs, i.e., executive director, accounting staff, purchasing, space, etc., through direct charges to grants and contracts. Unfortunately, these charges tend to be based on budget estimates or arbitrary allocations based on the availability of funds. This procedure is not in compliance with federal cost principles and places the grantee at serious audit risk under new audit guidelines being developed. The application of an indirect cost rate results in a much more equitable distribution of indirect costs.

An indirect cost rate should be established by grantees who administer a variety of programs funded by Federal, State, and local agencies. Agencies receiving direct Federal grant funds should establish an indirect cost rate for their programs with the cognizant Federal agency. Agencies receiving funds from State agencies only, should initiate negotiations with the appropriate State agency to establish an indirect cost rate for their programs.

**POLICY:**

Cost principles for Nonprofit Organizations contained in OMB Circular A-122.

This Memorandum discusses direct costs versus indirect costs and encourages all eligible entities to establish an indirect cost rate for local agencies.

**PURPOSE OF  
THE INDIRECT  
COST RATE:**

(A) Indirect cost principles, as provided in OMB Circular A-122, are used by all Federal and State agencies in determining the costs of work performed by nonprofit organizations under grants, cooperative agreements, or other contracts where costs are used in administration, pricing or for contractual settlements.

(B) The "Audit Compliance Supplement" is being revised for OMB Circular A-133 which will require auditors to examine closely a multi-program agency's cost allocation procedures. If an agency does not have an indirect cost rate, auditors will have to determine the basis for sharing costs among the programs. Where indirect cost rates have not been established, auditors may question an agency's cost allocation procedures, resulting in disallowed expenditures in the various programs.

(C) Improved accounting and assignment of costs is essential in assessing "performance and results" in state and local agencies as required in Section 675(c)(9) of the CSBG Reauthorization Act of 1994, Public Law 97-35 as amended and Public Law 103-62, Government Performance and Results Act of 1993.

**WHAT DOES  
THE RATE  
ACCOMPLISH?**

(A) An indirect cost rate (ICR) in an agency that receives multiple funding sources will provide for systematic and accurate charges and result in an equitable distribution of indirect costs.

(B) Agencies utilizing indirect cost rates have found it to be a positive move and a better system for cost accounting among local multiple programs.

(C) An ICR eases accounting burdens through cost pooling and eliminates arbitrary direct charging of management and administrative costs.

(D) An ICR improves the agency's ability to use CSBG funding to cover shortfalls in recovery.

(E) An ICR encourages all funding sources to pay their fair share as determined by the established cost rate.

(F) An ICR develops actual costs, which are essential for assessing results and performance under Results Oriented Management.

(G) Note that in many situations, an indirect cost rate will not eliminate the need to develop cost allocation methodologies for common or joint costs that are not indirect in nature. For example, a cafeteria might provide meals to Head Start children, offer a congregate meals program for the elderly as well as prepare food for an elderly meals-on-wheels program. While the cafeteria activity receives a distribution of indirect costs from all programs (such as staff salaries), other actual costs must be further allocated/targeted to the Head Start and elderly programs, such as the actual cost of a meal or transportation costs for the congregate meals and/or meals delivered to the home.

(H) However, a cost allocation plan is not a substitute for an indirect cost rate. Cost allocation deals with other kinds of cost that are allocated as a direct charge on a line-by-line basis. These costs could be grouped into a common pool like the cafeteria.

**WHAT ARE  
DIRECT  
COSTS?**

(A) Direct costs are those that can be identified specifically with a final or intermediate cost objective: i.e. a project, a service or other direct activity of an organization.

(B) Salaries, including associated fringe benefits of personnel whose work or effort can be directly identified or charged to a particular program or activity.

(C) Cost of materials and other supplies acquired, consumed or expended for the purpose of the program or activity:

- Travel Costs
- Equipment
- Contracts
- Other costs directly identified as a cost of the program

**WHAT ARE  
INDIRECT  
COSTS?**

(A) Indirect costs are those that have been incurred for common objectives benefitting all programs and cannot be readily identified or assignable to a particular final cost in a program (A-122). Indirect costs relate to central management and administrative functions that are necessary and beneficial to all programs administered by the grantee organization.

(B) Salaries and wages related to the:

- Executive Director of the organization
- Deputy Director or similar positions
- Controllers, accountants, bookkeepers
- Business manager
- Secretarial positions to above personnel
- Personnel Management

(C) Fringe benefits associated with above personnel:

- Pension
- Hospitalization
- Life Insurance
- Unemployment

(D) Operations and maintenance costs (common costs) allocable in part to central management and administrative functions such as:

- Rent
- Utilities
- General repair and maintenance
- Liability Insurance
- General office supplies, postage, telephone, photocopy

(E) General legal costs

(F) Organization wide single audits (financial and compliance)

(G) Travel related to central management and administrative functions

**WHO NEGOTIATES  
AND APPROVES  
INDIRECT  
COST RATES?**

(A) The Federal agency with the largest amount of direct grant dollars with the grantee organization will be designated as the cognizant agency for the negotiation and approval of the indirect cost rates and where necessary other rates such as fringe benefits or other common costs.

(B) All concerned Federal agencies shall be given the opportunity to participate in the negotiation process, but after a rate has been established it will be accepted by all Federal agencies.

(C) The grantee organization prepares an indirect cost proposal and submits the proposal to the appropriate Federal agency. Proposals are based on previous actual costs. All proposals should be submitted six months prior to the agency's beginning fiscal year.

(D) Community Action Agencies that do not have direct Federally funded programs should negotiate with their State CSBG agency and the State Comptroller's Office to establish indirect cost rates for their agency. Appropriate indirect cost rates will: 1) minimize future audit risk and put the agency in readiness for assessing results and performance, based on actual costs; 2) put the agency in a pro-active posture when responding to questioned costs and audit disallowances; and 3) ensure that an agency will meet OMB Circular A-133 requirements and avoid disallowed expenditures resulting from an inappropriate cost allocation plan.

(E) Grantees interested in establishing indirect cost rates should contact their regional Health and Human Services (HHS) Division of Cost Allocation Field Office (see last attachment). The HHS Division of Cost Allocation will refer grantees to other Federal cognizant agencies as appropriate.

**HOW ARE  
INDIRECT COSTS  
IMPLEMENTED?**

(A) The grantee organization implements indirect costs in its accounting and financial reporting system at the beginning of the organization's fiscal year. However, to allow time for the review and negotiation process, the initial proposal should be submitted well in advance of the organization's fiscal year to allow time for the review and negotiation process.

(B) An indirect cost proposal's compliance is verified by the agency's annual audit, where actual year end rates are confirmed.

(C) Rates are implemented for budgeting costs in all programs, thereby assuring that each program recognizes its full share, regardless of cost limitations.


(D) Attached is an example of a Nonprofit Indirect Cost Proposal that outlines the steps to be completed in applying for an indirect cost rate.

**NOTE:**

This memorandum has been cleared by the HHS Office of Grants and Acquisition Management and the HHS Division of Cost Allocation.

**INQUIRIES:**

Comments and inquiries may be sent to:  
Bryant Tudor, U.S. Department of Health & Human Services, Administration for Children and Families, Office of Community Services, 370 L'Enfant Promenade SW, Washington, DC 20447.  
Telephone (202) 401-5535

  
Donald Sykes  
Director  
Office of Community Services

**Attachments:**

***EXAMPLE OF NONPROFIT***

***INDIRECT COST PROPOSAL***

# INDIRECT COST RATE PROPOSAL

## For The Year Ended June 30, 19XX

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### A. INTRODUCTION

Name of Organization (Agency) is a not-for-profit located in Any Town, USA. The agency administers a variety of programs funded by Federal, State, and local agencies. These programs include Community Services programs, Head Start programs, State Weatherization, and Food Service programs. This example assumes a June 30 year end. Organizations can have different year ends and should use the year end of their organization when preparing indirect cost proposals.

### B. COST ALLOCATION METHODOLOGY

This proposal is for a indirect cost rate based on the Agency's actual costs for its fiscal year beginning July 1, 19XX and ending June 30, 19XX. The proposal is based on the Agency's organization-wide audit report (Statement of Functional Expense Statement) for the year ended June 30, 19XX.

This proposal addresses all elements of cost incurred by Name of Organization and identifies shared costs that require allocation.

The Agency treats all costs as direct costs except general administration and general expenses. Joint costs are prorated individually as direct costs to each category and to each award using a base most appropriate to the particular cost being prorated. Therefore, the direct allocation method has been used in allocating indirect costs.

### C. DIRECT COSTS

Direct costs are costs that can be identified specifically with a project and therefore are charged to that project. The accounting system records these costs as they are incurred within the series of accounts assigned for that propose and further distribution is not required.

### D. INDIRECT COSTS

Indirect costs are costs incurred for common or joint objectives and therefore cannot be readily and specifically identified with a particular project or activity. These costs are grouped into common pool(s) and distributed to benefiting activities by a cost allocation process.



# INDIRECT COST RATE PROPOSAL

## For The Year Ended June 30, 19XX

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### E. COST POOL AND BASE FOR DISTRIBUTION

*The Agency has created an Administrative Services Pool consisting of salaries, fringe benefits, and non-salary costs. The Administrative Services Pool is charged with all the indirect costs as defined above. This pool is distributed to the various program activities on the basis of direct salaries, including vacation, holiday, and sick pay but excluding other fringe benefits expended on those activities. Volunteers for the Head Start program are included in the direct salaries based on Department of Health and Human Services rulings*

*The total direct salaries and wages on which this proposal is based is \$1,111,343 which includes \$99,230 of volunteer salaries and wages for the Head Start program*

### F. SUPPORTING FINANCIAL STATEMENTS

*The Schedule of Total Expenditures (Schedule C) contained in this proposal agrees to the Agency's audit report Statement of Functional Expenses included with this report.*

●	Audit report	<u>\$2,632,449</u>
	Statement of Functional Expenses	
●	Indirect Cost Proposal	<u>\$2,632,449</u>

**NOTE:** *The audited financial statement has not been included in this example and is assumed to agree to the proposal.*

## INDIRECT COST RATE PROPOSAL For The Year Ended June 30, 19XX

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### G. SALARIES

*Listed below are the positions, functions, and budgeted annual salaries for the people who comprise the Administrative Services Pool. These positions are charged 100% to Administrative Services.*

<u>Position</u>	<u>Function</u>	<u>Salary</u>
<i>Executive Director</i>	<i>General Management</i>	<i>\$ 48,754</i>
<i>Deputy Director</i>	<i>General Management</i>	<i>30,664</i>
<i>Administrative Assistant to Executive Director</i>	<i>General Management</i>	<i>21,566</i>
<i>Administrative Secretary/ Personnel Officer.</i>	<i>Clerical support to the Executive Director and Administrative Assistant Responsible for personnel information</i>	<i>17,087</i>
<i>Finance Officer</i>	<i>Accounting and related activities</i>	<i>26,484</i>
<i>Bookkeeper</i>	<i>Accounting</i>	<i>20,797</i>
<i>Bookkeeper</i>	<i>Accounting</i>	<i>17,215</i>
<i>Bookkeeper/Payroll Clerk</i>	<i>Payroll accounting and general disbursements</i>	<i>16,560</i>
<i>Custodian</i>	<i>Cleaning</i>	<i>2,936</i>
<i>Receptionist</i>	<i>Switchboard/Clerical</i>	<u><i>14,232</i></u>
<i>Total Administrative Services Pool salaries</i>		<u><i>\$216,295</i></u>

## INDIRECT COST RATE PROPOSAL For The Year Ended June 30, 19XX

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### H. FRINGE BENEFITS

*Fringe benefits associated with the positions within the Administrative Services Pool are as follows:*

*Payroll taxes:*

<i>FICA (actual paid)</i>	<i>\$16,546</i>	
<i>State Unemployment (actual paid)</i>	<u><i>1,145</i></u>	<i>\$17,691</i>
<i>Hospitalization and Life Insurance (actual paid)</i>		<i>22,474</i>
<i>Retirement Plan (actual paid)</i>		<u><i>3,050</i></u>
<i>Total</i>		<u><i>\$43,215</i></u>

*A copy of the Agency's fringe benefit policies is attached. The fringe benefit policy is not attached for this example, However, the fringe benefit policy should be attached for an actual submission.*

### I. NON-SALARY COSTS

*Each category on non-salary expenditures has been analyzed based on the facts, and Schedule B shows the allocation between the direct and Administrative Services Pool. Total non-salary direct costs excluding indirect cost reimbursements are \$984,656 of which direct is \$861,966 and indirect is \$122,690.*

## INDIRECT COST RATE PROPOSAL For The Year Ended June 30, 19XX

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### J. COMPUTATION OF BASE AND POOL COSTS

Schedule A (attached) shows the computation of the indirect cost rate for the year ended June 30, 19XX. A summary of the rate calculation follows:

*Direct Costs (Base - Salaries and Wage):*

Community Service	\$ 140,831
Head Start	950,615
Weatherization	18,305
Memberships	<u>1,592</u>
Total Direct Salaries	<u>\$1,111,343</u>

*Indirect Costs (Pool):*

Administrative Services salaries	\$ 216,295
Administrative Services fringe benefits	43,215
Administrative Services non-salary costs	<u>122,690</u>
Total Administrative Services	<u>\$ 382,200</u>

### K. RATE

Adjusted indirect costs (above - pool)	<u>\$ 382,200</u>	= 34.3%
Total direct salaries (above - base)	\$1,111,343	

### L. FUNDING OF RATE

When the above rate is applied to the direct salaries paid from the State Department of Human Resources funds (Community Services Block Grant) and funds from the U.S. Department of Health and Human Services (Head start Grant), the eligible reimbursement is \$374,365 ( $140,831 + 950,615 = 1,091,446 \times 34.3\% = 374,365$ ). However, the allowable budgeted funding for indirect costs was significantly less than the eligible reimbursement. The Department of Energy programs and other local funds will have to absorb their fair share of the difference, within their funding limitations. The Agency will apply to outside sources to absorb any differences in indirect costs paid by the other programs.

**INDIRECT COST RATE PROPOSAL**  
**For The Year Ended June 30, 19XX**  
**Schedule A**

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**FUNCTIONAL GROUPINGS**

**Direct Costs (Base - Salaries and Wage):**

		<u>Total Salaries</u>
Community Services Block Grant		\$ 140,831
Head Start		
Salaries	\$851,385	
Volunteers	<u>99,230</u>	950,615
Weatherization		18,305
Membership		<u>1,592</u>
Total direct S&W		<u>\$1,111,343</u>

**Indirect Costs (Pool):**

Labor Costs		\$259,510
Non-Labor Costs		<u>122,690</u>
Adjusted Administrative Services Pool		<u>\$382,200</u>

**RATE:**

Adjusted indirect costs (above - pool)	<u>\$ 382,200</u>	= 34.3%
Total direct salaries (above - base)	\$1,111,343	

**INDIRECT COST RATE PROPOSAL  
For The Year Ended June 30, 19XX  
Schedule B**

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<u>Elements of Cost</u>	<u>Methodology of Allocation</u>
<i>Contractual Services</i>	<i>Actual usage.</i>
<i>Depreciation/Use allowance</i>	<i>Indirect cost.</i>
<i>Emergency assistance payments</i>	<i>Direct cost.</i>
<i>Equipment rental and maintenance</i>	<i>Rental and maintenance on equipment used in central office finance office.</i>
<i>Equipment/Capital</i>	<i>Purchase of office furniture for use in performing administrative services.</i>
<i>Equipment/Minor</i>	<i>Actual usage.</i>
<i>Food costs</i>	<i>Direct cost.</i>
<i>Insurance</i>	<i>Actual usage.</i>
<i>Occupancy</i>	<i>Central office repairs and utilities on basis of square footage used for administrative services.</i>
<i>Office supplies</i>	<i>Office and janitorial supplies for administrative and program purposes.</i>
<i>Other expenses</i>	<i>Based on administrative services actual use.</i>

**INDIRECT COST RATE PROPOSAL**  
**For The Year Ended June 30, 19XX**  
**Schedule B (Con't)**

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<u>Elements of Cost</u>	<u>Methodology of Allocation</u>
Postage	Actual usage.
Professional fees	Accounting and audit services, payroll processing services, charged on work performed for administrative services.
Program Supplies	Programs are charged to project as costs are incurred. Costs are direct cost.
Printing	Actual usage.
Renovations and improvements	Direct cost.
Telephone	Basic services allocated on number of instruments, toll calls charged on basis of logs of such calls for administrative services.
Travel	Charged based on actual administrative and program use of vehicles. Cost include mileage, transportation, per diem, gas, oil, repairs, and insurance on vehicles.

**The methodologies used in this example are not recommended methodologies. They are used for purposes of example only. Allocation of costs should be accomplished on a cost benefit basis. This cost benefit can be different from one organization to the next.**

Indirect Cost Proposal  
 Total Expenditures  
 For The Year Ended June 30, 19XX  
 Schedule C

Elements of Cost	Expenditures Per Audited Financial Statements	Adjustments	DIRECT COSTS				Total Direct Costs	INDIRECT COSTS
			Community Service	Head Start	Weatherization	Membership		Administrative Services Pool
Salaries and wages	\$1,327,638 A	\$0	\$140,831	\$950,615 A	\$18,305	\$1,592	\$1,111,343	\$216,295
Payroll taxes	100,475	0	11,519	69,638	1,497	130	82,784	17,691
Group insurance	127,638	0	14,633	88,464	1,902	165	105,164	22,474
Retirement	17,321	0	1,986	12,005	258	22	14,271	3,050
Sub total labor	\$1,573,072	\$0	\$168,969	\$1,120,722	\$21,962	\$1,909	\$1,313,562	\$259,510
Contractual Services	245,420	0	3,493	207,770	34,157	0	245,420	0
Depreciation/Use allowance	41,582	0	0	0	0	0	0	41,582
Emergency assistance payments	72,859	0	52,809	0	20,050	0	72,859	0
Equipment rental and maint	11,448	0	592	5,197	0	281	6,070	5,378
Equipment/Capital	58,215	(58,215) B	0	0	0	0	0	0
Equipment/Minor	546	0	0	0	546	0	546	0
Food costs	124,616	0	0	124,616	0	0	124,616	0
Insurance	12,554	0	92	8,209	85	373	8,759	3,795
Occupancy	129,314	0	24,637	100,956	459	233	126,285	3,029
Office supplies	32,540	0	1,794	13,317	3,649	842	19,602	12,938
Other expense	36	(36) D	0	0	0	0	0	0
Postage	3,901	0	476	301	125	2,467	3,369	532
Professional fees	34,211	0	0	0	0	0	0	34,211
Program supplies	109,663	0	7,603	55,241	40,659	6,160	109,663	0
Printing	65,697	0	5,140	7,022	1,345	44,838	58,345	7,352
Renovations and improvements	16,470	(16,470) C	0	0	0	0	0	0
Telephone	29,013	0	5,788	13,331	349	600	20,068	8,945
Travel	71,292	0	7,298	56,553	2,513	0	66,364	4,928
Sub total non-labor	\$1,059,377	(\$74,721)	\$109,722	\$592,513	\$103,937	\$55,794	\$861,966	\$122,690
Total	\$2,632,449	(\$74,721)	\$278,691	\$1,713,235	\$125,899	\$57,703	\$2,175,528	\$382,200

EXPLANATION OF ADJUSTMENTS:

- A - Includes salaries and wages of \$99,230 for volunteers of the head start program
- B - Exclude capital equipment purchases
- C - Exclude capital renovations and improvements
- D - Remove unallowable costs - \$22 Interest + \$14 Bad Debt = \$36



# NON-PROFIT INDIRECT COST PROPOSAL (ICP) CHECKLIST

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1. The ICP is supported by: (Include a copy of this document along with your ICP.)

CPA report. If not available, one of the following documents:

Federal Form 990

Internal Financial Statements

Other \_\_\_\_\_

2. A reconciliation of item 1 (above) to the ICP has been made and is included in this proposal.
3. Unallowable expenses have been eliminated from the indirect cost pool (e.g., contributed salaries and services, bad debts, fund-raising, advertising, independent research and development [IR&D], depreciation of Federally funded assets and lobbying costs).
4. The direct cost base is complete (i.e., it included all activities that benefit from the indirect cost pool). For example, fund-raising, IR&D, project cost sharing and voluntary services are included where applicable.
5. A functional analysis of salaries and wages included in the indirect cost pool. (If any function is less than 100%, show the percent.)
6. Treatment of Paid Absences and Fringe Benefits statements have not changed since the last indirect cost agreement.
7. We have not made any significant changes, during the proposal fiscal year, (i) to our accounting system, or (ii) to the definition or to the accounting treatment of any expense category (e.g., a change in building/equipment costing methodology, a change in charging an expense from direct to indirect or visa versa).
8. We have not changed the equipment capitalization threshold during the proposal fiscal year. The capitalization level is \$ \_\_\_\_\_. (If there is a change made during the proposal fiscal year, indicate the effective date of the change and the new capitalization level on a separate sheet.)
9. The required "Lobbying Cost Certificate" is attached.

**Please explain any boxes not checked on a separate sheet.**

\_\_\_\_\_  
Signature Date

\_\_\_\_\_  
Title

\_\_\_\_\_  
Organization

## LOBBYING COST CERTIFICATION

I hereby certify that the \_\_\_\_\_  
(name of organization)  
has complied with the requirements and standards on lobbying costs in paragraph  
of OMB Circular A-122 for the fiscal year ended \_\_\_\_\_  
(fiscal year covered by indirect cost proposal)

\_\_\_\_\_  
Signature

\_\_\_\_\_  
Name

\_\_\_\_\_  
Title

\_\_\_\_\_  
Date

(Signed by the official having the authority to negotiate indirect cost rates for the organization or by a higher level official)

**Note: The above certification is a requirement of OBM Circular A-122. We will not be able to process your indirect cost proposal without this certification.**