MEMORANDUM

March, 2007

TO: All State and Federal Grant Recipients

FROM: Tim Imler
Division Administrator
Division of Funding and Disbursement Services

SUBJECT: Indirect Costs and Related Issues

This memorandum is intended to clarify issues regarding Direct and Indirect Costs and how they are charged to state and federal grant programs administered by the Illinois State Board of Education (ISBE). Details of these changes can be viewed on pages 14-19 in the State and Federal Grant Administration Policy, Fiscal Requirement and Procedures. These changes are in accordance with ISBE’s delegated authority and the appropriate federal Office of Management and Budget Circular limited by the costs allowable under the particular grant.

Indirect Costs - Defined
Indirect costs are costs an organization incurs for common or joint objectives that cannot be readily and specifically identified with a particular grant project or other institutional activity. These are typically widespread costs for support service activities such as purchasing, budgeting, payroll, accounting, data processing, and staff services. Indirect costs are usually charged to the grant as a percentage of some or all of the direct cost items in the applicant’s budget; this percentage is called the indirect cost rate.

The following expenditure functions are usually considered as indirect costs:

- Function 2510 - Direction of Business Support Services
- Function 2520 - Fiscal Services
- Function 2570 - Internal Services
- Function 2640 - Staff Services
- Function 2660 - Data Processing Services

If expenditures are shown as direct costs in any of the above mentioned functions on the program budget, the indirect cost rate cannot be used.
Direct vs. Other “Administrative Overhead Types” of Costs
There are other “administrative overhead types” of indirect costs (e.g. telephone, copying and postage) that are incurred within a central district office which are normally charged in Function 2300 General Administration and/or Function 2400 School Administration. In addition, there may be specific program (e.g. Grants Coordinator) administrative salaries which may be direct costs, e.g. benefits and supplies that are charged in General Administration Sub-Function 2330 Special Area Administrative Services, and/or School Administration Sub-Function 2490 Other Support Services.

Cost Allocation Plan
A Cost Allocation Plan (CAP) is a document that states how a district will identify, accumulate and distribute certain allowable administrative costs in grants and identifies the allocation methods used for distributing the costs. A written plan for allocating joint costs is required to support the distribution of those costs to the grant program. When a local education agency completes a grant application/amendment, it must determine to either utilize its restricted indirect cost rate as calculated by the Illinois State Board of Education or utilize a CAP which must then be documented via personnel time and effort information as well as formal accounting records according to generally accepted governmental accounting principles to substantiate the propriety of the eventual charges. All applicable documentation must be available for review upon request by a local auditor or ISBE compliance monitor.

In most instances, the simultaneous use of direct cost allocation and the indirect cost rate application is prohibited. However, there may be legitimate instances where a general administration cost is requested and approved as a direct cost in addition to other administrative overhead costs that are covered under an indirect cost rate.

Example – Grants Coordinator in Central Office
A federal grants coordinator works in the central district office along with other staff that have oversight over other grant programs. The direct cost (e.g. salary and benefits) for the grants coordinator with respect to certain services (e.g. Special Area Administrative Services Sub-Function 2330) may be charged as a direct cost on a federal grant utilizing a CAP with supporting records and documentation that are maintained by the district in accordance with the applicable OMB Circular. The functions that may be utilized with a CAP may include, but are not necessarily limited to, supervisory responsibilities or other administrative services for the specific grant as the federal grants coordinator along with the recognition of appropriate supplanting rules. Ancillary administration costs within the central office (e.g. telephone, copying, postage etc.) which may not be charged as direct cost would be allowed under the indirect cost rate.
The "Certifications and Assurances, and Standard Terms of the Grant" assurances have been modified to include the following statement:

**Cost Allocation Plan.** Applicants that do not have a calculated indirect cost rate from the Illinois State Board of Education or do not utilize their restricted indirect cost rate as calculated by the Illinois State Board of Education, certify that they have developed a written Cost Allocation Plan (CAP) that: i) will be utilized in identifying the accumulation and distribution of any allowable administrative costs in the grant program; ii) identifies the allocation methods used for distributing the costs among programs; iii) requires support through records and documentation showing personnel time and effort information, and formal accounting records according to generally accepted governmental accounting principles; iv) requires the propriety of the charges to be substantiated; and v) shall be made available, along with any records or supporting documentation for allowable administrative costs, for review upon ISBE’s request.

**Indirect Cost Rates for Local Education Agencies**
Depending on the type of organization approved for grant funds, the following should be used as a guide if the local education agency decides to apply the appropriate indirect cost rate as determined by the Illinois State Board of Education.

- School districts must use their restricted indirect cost rates.
- Newly organized LEAs and governmental entities formed by a joint agreement must utilize the state-wide average indirect rate.
- LEAs which jointly administer a state or federal program must utilize the approved indirect cost rate for the administrative district of the joint program.
- Regional Offices of Education, Intermediate Service Centers, not for profit agencies, community/faith-based organizations and other subgrantees must use the state-wide average if they wish to include indirect costs on state or federal grants. This average is determined each fiscal year based upon the actual indirect cost rates calculated.
- Colleges and Universities will be restricted to a maximum indirect cost rate of 8% or other indirect cost rate calculated by their cognizant federal agency, whichever is less, for all state and federal grants administered by the Illinois State Board of Education.
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Retirement, Termination and Severance Pay Cost
In the past, local education agencies have applied a variety of costs for retirement, severance pay and/or termination for individuals charged to state and federal grants. Please be advised that any abnormal, lump sum severance or accelerated early retirement expenditures (including the 2.2 Teachers Benefit Increase option provided by the Teachers Retirement System) or other costs in addition to normal, annual salaries are not allowed to be charged as a direct cost on any state or federal grants and may now only be claimed as an indirect cost. This information represents a major shift from previous guidance provided on this issue.

Retirement – when an employee has chosen to end their employment, the costs associated in the fiscal year of this action may be included as a direct cost to the grant. This may include compensation for unused sick and/or vacation days paid as part of the individual’s annual salary.

Termination and Severance – Severance payments, defined as any disbursement/expenditure made in addition to regular salaries and wages for workers whose employment was terminated in the current school year, must be charged as indirect costs. Examples of one-time abnormal or mass severance that must be charged as an indirect cost include expenses associated with events that are offered to employees as an incentive to leave employment such as:

- Buy-outs
- Lump sum payments linked to years of service
- Increased pension benefits

A good rule of thumb when questioning these costs is that if the payment confers a benefit to the affected program then it may be included as a direct cost of the program. When the payment confers no direct benefit to the program, it can only be charged indirectly to the program.

Local education agencies identifying abnormal or mass severance expenses in the Annual Financial Report will not be provided indirect cost rates by ISBE without approval of such costs by the USDE. LEAs will need to directly contact the USDE for approval and subsequent notification to ISBE.

IMPORTANT: All grantees with any abnormal, lump sum, accelerated or mass severance expenses for individuals approved on a current FY 2007 grant are highly encouraged to amend their grant to comply with this new guidance. Full compliance will be expected for all FY 2008 grants.

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