

**Michigan Department of Education
Office of State Aid and School Finance**

**Local School Districts
Public School Academies
Intermediate School Districts
Indirect Cost Rate Instructions
April 2015**

The process for compiling federal indirect cost rates for local school districts, public school academies, and intermediate school districts has changed!

The collection of school district financial data through the Financial Information Database (FID) has changed the way the state can present preliminary data used to compile federal indirect cost rates. As a result, local school districts, public school academies and intermediate school districts will all use forms R0418 and R0418A as a basis for the development of restricted, unrestricted, and Medicaid School Based Services (Medicaid) indirect cost rates. Preliminary rates will be issued using traditional classifications between indirect and direct costs. The districts will be responsible for reviewing the information provided and submitting adjustments if necessary. Any district that uses an indirect cost rate to bill for administrative costs should review the calculation of those rates in order to insure accuracy.

Following is a discussion on the concept of indirect costs and instructions related to the type of adjustments that should be made.

What are indirect costs?

Indirect costs are defined as costs that are incurred for the benefit of more than one cost objective, but are not readily assignable to any program or grant. Indirect costs serve common or joint purposes, and to identify the specific program or grant served would take an effort disproportionate to the results achieved. Typically, salaries and expenses for auditing, budgeting, payroll, personnel, purchasing and employee relations are examples of costs which are considered indirect.

What is an indirect cost rate and why should my district be interested in having an approved indirect cost rate?

An indirect cost rate is a ratio, based upon the proportion of all the organization's indirect costs to all the organization's direct costs. Direct costs are defined as those costs which are readily identified with a grant, contract, or project. The total direct costs of any grant or activity can be multiplied by this indirect cost ratio, thus providing a reasonable approximation of the indirect costs of that grant or activity. The full cost of the activity includes both the direct costs and the indirect costs assigned via the indirect cost rate. For example, if your organization has a 4.0% indirect cost rate and spends \$48,000 in salaries, benefits, travel and supplies for a specific program, it can be assumed that it costs an additional \$1,920 to provide services such as payroll processing, human resource management, supply

requisitioning, etc. to the program. The complete cost of the program is \$49,920.

When an organization has an approved indirect cost rate, it is allowed to assign a value for indirect costs to grants or projects. In the majority of grants, it is permissible to request reimbursement for both direct and indirect costs to the extent of the grant award.

What is the difference between an unrestricted indirect cost rate, a restricted indirect cost rate, and a Medicaid cost rate?

The *unrestricted* indirect cost rate represents the ratio of costs that benefit all programs but can't be specifically or readily identified with any program (all indirect costs) to costs that can be identified with programs or functions (direct costs). The costs of operations and maintenance and the chief executive officer(s) can be included in the numerator of this more complete ratio. However, very few federal programs allow the use of the unrestricted indirect cost rate. This rate is capped at 15%.

The *Medicaid* indirect cost rate is similar to the unrestricted indirect cost rate, in that it includes the costs of operations and maintenance and the chief executive officer. The only difference between the Medicaid indirect cost rate and the restricted indirect cost rate is that the Medicaid rate is capped at 25%.

Most U.S. Department of Education grants allow the use of the *restricted* indirect cost rate. The numerator of this restricted ratio includes those costs that benefit all programs but can't be specifically or readily identified with any program, however, additional restrictions are placed on the costs. Costs associated with the operation and maintenance of the organization cannot be included in the numerator, nor can the costs of the chief executive officer or the chief executive officer's component units (usually defined as associate superintendents.) These costs, instead, are included in the denominator of the ratio. This rate is capped at 15%.

The concept of "supplement but not supplant" is the basis behind the restricted ratio. When a program requires the use of the restricted rate, it is because those federal funds are intended to add to current programs, not replace or supplant those programs. Operations and maintenance and the chief executive office are considered functions that any school would have to support, regardless of whether or not the school ran federally funded programs or grants.

How do I start the process of obtaining an indirect cost rate?

Each organization has expenditure patterns unique to their structure and operation. The first step in formulating an indirect cost rate is to compile expenditure data for your organization from the most recently completed fiscal year. The district's 2013-2014 expenditure data will be used as a projection of the expenditures for 2015-2016. Once the base of all expenditures is determined, costs need to be classified as excluded, direct, unallowable, or indirect (restricted and/or unrestricted). Using this information, a carry-forward calculation is done that compares the indirect cost ratios developed for the base year to the actual results. Indirect costs, as adjusted by the carry-forward amount, are used as the numerator of the indirect cost ratio.

Direct costs plus unallowable costs are used as the denominator for the indirect cost ratio.

How do I classify costs between indirect (restricted, unrestricted, and Medicaid), excluded, direct or unallowable?

When determining how expenditures should be classified, it may be helpful to ask the following questions:

- A. Can the costs be identified specifically with one program or activity? If so, the costs are considered to be **direct costs**.

- B. Do the expenditures pertain to:
 - 1. The school board,
 - 2. Contributions or donations, or
 - 3. Entertainment?If so, the expenditures are considered **unallowable**, and are treated similar to direct costs for the purpose of calculating indirect cost ratios.

- C. Do the costs relate to:
 - 1. Capital outlay,
 - 2. Debt Service,
 - 3. Judgments,
 - 4. Fines or penalties,
 - 5. Bad debts,
 - 6. Election expenses,
 - 7. Food for food service and items purchased for resale,
 - 8. Purchased service contracts in excess of \$25,000 that impact the direct cost base? For this exclusion, the first \$25,000 of the contract is included; costs in excess of \$25,000 are excluded. To be consistent, if any of these major contracts relate to a federal grant, indirect should be charged only on the first \$25,000 of the contract. See more details regarding this rule at http://www.michigan.gov/documents/mde/25Krule_331378_7.pdf.
 - 9. Flow-through grants?
If so, the costs are considered to be distorting and are classified as **excluded costs**.

- D. Do the costs benefit all programs in general and cannot be readily identified with any program? If so, the costs are **unrestricted indirect costs and Medicaid indirect costs**.

- E. Subtract from the unrestricted indirect costs any expenditures related to Operations and Maintenance and the Chief Executive Officer's immediate office, including any Deputies or similar offices and their immediate support staff. The remainder is the value of **restricted indirect costs**.

Please note that many of the expenditures can be considered either direct, restricted indirect and/or unrestricted and Medicaid indirect, dependent upon

the nature and the treatment of the costs. However, under no circumstance may a cost be considered both direct and indirect.

What is the process for obtaining approved indirect cost rates?

For the 2015-2016 federal indirect cost rate cycle forms R0418 and R0418a will ~~also~~ be available at web site http://www.michigan.gov/mde/0,1607,7-140-6530_6605-118785--,00.html . Form R0418 contains the Carryforward Calculation of the preliminary restricted, unrestricted, and Medicaid indirect cost rates. Form R0418a contains a recap of the district's financial data from the preceding fiscal year on which the following fiscal year's preliminary indirect rates are based. Form DS-4513 is used to adjust and improve the data on the R0418a so the rate accurately represents the operations of the district. Form DS-4513 *SCHOOL DISTRICT: INDIRECT COST RATE ADJUSTMENTS* and instructions are available on-line at http://www.michigan.gov/mde/0,1607,7-140-6530_6605-118785--,00.html.

Instructions for completing DS-4513 for 2015-2016 indirect cost rates:

1. Verify the data on the R0418/R0418a: The expenditure information provided on forms R0418 and R0418a represent costs reported on the fiscal year 2013-2014 FID. All costs of the school district have been included to better comply with federal guidance. Indirect and direct cost information provided on the Carryforward Calculation has been extracted from the Carryforward Calculation section on the R0418 for the 2013-2014 indirect cost rates. Please verify the accuracy of the data. Contact Phil Boone at (517) 335-4059 if the information is not correct.
2. Determine the Need for Adjustments: Preliminary Reports R0418 and R0418a classify expenditures as excluded, direct, indirect unrestricted, and/or indirect restricted based upon the typical classification of expenditures represented by the account. The classification may or may not be accurate, depending upon the expenses reflected by the value. The purpose of form DS-4513 is to report adjustments to the expenditure classifications to accurately represent the district's ratio of indirect costs to direct costs. Please note that there will be no adjustments made for misclassification of costs due to failure to properly code expenses on the FID. FID reporting must be done according to the account structure from the Michigan School Accounting Manual. If your district's account structure does not align with that of the Michigan School Accounting Manual you should seek to change your structure in time for the November 2015 FID reporting deadline.

It is not mandatory that you adjust the preliminary information. If the amounts recorded on report R0418 are an accurate representation of indirect and direct costs, please complete the identification and certification portions and check box A of form DS-4513 and return the form to Michigan Department of Education, ATTN: Phil Boone, Office of State Aid and School Finance, P.O. Box 30008, Lansing, MI 48909 by June 1, 2015. **The deadline date for the return of the DS-4513 is crucial and no adjustment requests will be accepted after that date.** As an alternative, you may either fax form DS-4513 and supporting worksheet to (517) 241-0196 ATTN: Phil Boone, or attach them to an e-mail to boonep2@michigan.gov.

NOTE: If you choose to submit by e-mail you must include the following statement in the body of the e-mail in addition to your name, title, and contact information:

"I hereby certify as the responsible official of said school district that the information contained in this indirect cost rate adjustment is correct and was prepared in accordance with state and federal requirements subject to specific grant limitations. I further certify that a consistent approach has been followed in treating a given type of cost as direct or indirect, and that in no case have costs of federally supported programs been included in the indirect costs reflected in this adjustment."

Please be aware if your district charged any of the costs classified as indirect costs on the R0418a directly to a program or grant, the cost must be adjusted as a negative to indirect costs and a positive to direct costs. Districts must certify that all costs are treated consistently and costs that have been charged as direct costs of federally-supported programs have not been included in the indirect cost pool. These adjustments are necessary to be in compliance with that certification.

3. Part I: Reporting Additional Exclusions:

Many of the costs that should be excluded when developing an indirect cost ratio can be identified through the FID elements. Those that can be identified have been classified under the exclusion column on the R0418a. You will not need to do anything to report these costs as excluded. It has been done for you. For this "automatic" exclusion, the following factors are used to identify those excluded costs:

For the general fund, special revenue fund, trust fund, and enterprise fund, the following costs are already classified as excluded on form R0418/R0418a:

1. Object codes starting with "6" – capital outlay
2. Object codes starting with "56" – Resale Supplies and Materials – includes cost of food for food service
3. Object codes starting with "71" – Redemption of Long-term Bonds, Loans and Capital Leases
4. Object codes starting with "72" – Interest on debt
5. Object codes starting with "73" – Other Financing and Debt Expenditures
6. Object codes starting with "75" – Claims and Judgments
7. Object codes starting with "76" – Taxes Abated and Written Off
8. Object codes starting with "85" – Sub Grantee Disbursements
9. Function Codes starting with "44" – Sub Grantee Payments (Flow Through Grants)

Expenses that are classified as follows are also excluded (automatically) due to the nature of the costs:

1. Debt Service Function 51X

2. Capital Project Fund
3. Internal Service Fund (costs would be duplicated in other funds)
4. District Wide Reporting

Adjustments will be required to exclude the following types of costs:

1. Fines and Penalties
2. Election Expenses
3. Major purchased service contracts in excess of \$25,000 that impact the direct cost base. For this exclusion, the first \$25,000 of the contract is included; costs in excess of \$25,000 are excluded. To be consistent, if any of these major contracts relate to a federal grant, indirect should be charged only on the first \$25,000 of the contract. Please keep in mind that Operations & Maintenance costs are considered direct in nature for the purposes of calculating the restricted rate.
4. Any excludable costs paid to Other Governmental Agencies reported in function codes starting with 41, 42 and 43.
5. Cost reported under the Enterprise Fund that are duplicated because they are also reported in another fund.

Record these additional exclusions in Part 1 of the DS4513. Provide an explanation or description of the cost, the fund and function code from the FID and the amount to be excluded.

4. Part II: Reclassification Between Direct and Indirect Costs:

Any expenditures that are recorded in the FID using State Codes 2XX through 8XX will be automatically classified as direct expenditures. State Codes in this range indicate a grant funded expenditure, which should be considered a direct cost. Should there be any costs directly attributed to a program or grant that were not designated as such by the State Code, an adjustment should be done to subtract the amount from the indirect unrestricted, indirect Medicaid, and indirect restricted costs and to add that cost to the direct and unallowable costs.

There are instances where the classification assumed by pulling financial data from the FID is incomplete or inaccurate. Guidance, by function code, is provided to assist you in reporting any necessary adjustments to your indirect cost information. Record these adjustments, by fund, function code and object code on page 2 of the DS4513. ***Please enter the adjustment to the Direct cost pool only. The form will fill in the appropriate adjustment to the Indirect cost pool, total the adjustments, and transfer the totals to page 1.***

Function codes 1xx (Instructional): All costs, other than the exclusions, must be considered direct. No adjustments are allowed.

Function codes 21x (Pupil Support): All costs, other than the exclusions, must be considered direct. No adjustments are allowed.

Function codes 22x (Instructional Support): All costs, other than the

exclusions, must be considered direct. No adjustments are allowed.

Function code 231 (Board of Education) costs, other than the exclusions, are considered direct and unallowable. The following object codes may be adjusted into the restricted, unrestricted, and Medicaid cost pools if they meet the definition of indirect costs and are not directly charged to specific programs:

3170	Legal Services
3180	Audit Services

Function codes 232 (Executive Administration) costs, other than the exclusions, are classified as direct and unallowable costs. These function codes are classified this way to portray the most conservative rates, however, adjustments are allowed to reflect more appropriate rates. Be aware that the costs of the superintendent's office, as the chief executive officer (CEO) of the school, can be included in the *unrestricted* and *Medicaid* indirect cost pools but not the *restricted* indirect cost pool. In addition, the costs of assistant or associate superintendents' offices can be included in the *unrestricted* and *Medicaid* indirect cost pools if they are not primarily responsible for a specific program. For example, the costs of the office of an assistant superintendent serving as a deputy CEO can be included in the *unrestricted* and *Medicaid* indirect cost pools, but the costs of the office of an associate superintendent of instruction cannot. If you would like a proportion of the cost associated with the superintendent's time to be allocated to the restricted indirect cost pool, you must split the costs between the 232 functions codes and the applicable 250 or 280 series function code in your submission of the FID.

Function code 233 (Grant Writer/Grant Procurement) costs, other than the exclusions, are classified as direct and unallowable costs, however, the following object codes may be adjusted into the unrestricted, Medicaid, and restricted indirect cost pool if they meet the definition of indirect costs and are not directly charged to specific programs. Please be prepared to explain why supplement, not supplant concepts apply when requesting an adjustment into the restricted indirect cost pool.

11xx	Administration
13xx	Professional - Business
14xx	Professional - Other
15xx	Technical
16xx	Operation and Service
17xx	Special Salary Payments *
18xx	Temporary Salaries
19xx	Overtime Salaries
2xxx	Employee Benefits*
31xx	Professional and Technical Services
32xx	Travel/Workshops - Staff
34xx	Communication
35xx	Advertisement*
36xx	Printing and Binding
41xx	Repairs and Maintenance Services

42xx	Other Repairs and Maintenance*
49xx	Other Purchased Services
54xx	Periodicals
59xx	Other Supplies
74xx	Dues and Fees
79xx	Miscellaneous

* Specific OMB Circular A-87 Criteria applies related to the allowability of these costs. See Attachment B, Selected Items of Cost. OMB Circular A-87 can be found at <http://www.whitehouse.gov/omb/circulars/a087/a087-all.html>

Function codes 24x (Support Services School Administration): All costs, other than the exclusions, must be considered direct. No adjustments are allowed.

Function Code 25x (Support Services Business) costs, other than exclusions, are classified as unrestricted, Medicaid, and restricted indirect costs. Should there be any costs directly attributed to a program or grant included in this classification, an adjustment should be done to subtract the amount from the indirect unrestricted, indirect Medicaid, and indirect restricted costs and to add that cost to the direct and unallowable costs.

Function Code 26x (Operations and Maintenance) costs, other than exclusions, are classified as unrestricted and Medicaid indirect costs. Should there be any costs directly attributed to a program or grant included in this classification, an adjustment should be done to subtract the amount from the indirect and Medicaid unrestricted costs and to add that cost to the direct and unallowable costs.

Function codes 27x (Pupil Transportation): All costs, other than the exclusions, must be considered direct. No adjustments are allowed.

Function Code 281 (Planning, Research, Development, and Evaluation) and Function Code 282 (Communication Services) costs, other than exclusions, are classified as direct costs. Adjustments into the unrestricted indirect, Medicaid indirect, and restricted indirect cost pools from the direct and unallowable cost pool will be accepted, provided the costs meet the definition of indirect costs and are not directly charged to specific programs or grants. See function code 233 for potential allowable object codes.

Function Code 283 (Staff/Personnel Services) and Function Code 284 (Support Services Technology) costs, other than exclusions, are classified as unrestricted, Medicaid, and restricted indirect costs. Should there be any costs directly attributed to a program or grant included in this classification, an adjustment should be done to subtract the amount from the indirect unrestricted, indirect Medicaid, and indirect restricted costs and to add that cost to the direct and unallowable costs.

Function Code 285 (Pupil Accounting): All costs, other than the exclusions,

must be considered direct. No adjustments are allowed.

Function Code 289 (Other Central Services) costs, other than exclusions, are classified as direct costs. Adjustments into the unrestricted indirect, Medicaid indirect, and restricted indirect cost pools from the direct and unallowable cost pool will be accepted, provided the costs meet the definition of indirect costs and are not directly charged to specific programs or grants. See function code 233 for potential allowable object codes.

Function Code 29x (Support Service – Other): All costs, other than the exclusions, must be considered direct. No adjustments are allowed.

Function Code 3xx (Community Services): All costs, other than the exclusions, must be considered direct. No adjustments are allowed.

Function Codes 41x (Payments to Other Public Schools Within the State of Michigan), 42x (Payments to Other Public Schools Outside the State of Michigan) and 43x (Payments to State Schools for the Deaf and Blind): All costs, other than exclusions are considered direct. An analysis of the costs contained in this category must be done to determine if the costs meet the criteria for indirect costs. If so, adjustments will be allowed.

Function Code 44x (Payments to Other Governmental and Not-For-Profit Entities/Subgrantee Relationships): All flow through transactions are excluded.

Function Code 45x (Facilities Acquisition): All costs, other than the exclusions, must be considered direct. No adjustments are allowed.

5. Carryforward Adjustment: The carryforward adjustment is calculated in MDE's indirect cost database. It is not necessary to calculate the adjustment manually. This section is provided for information purposes only.

After completion of the DS-4513, the information will be used to adjust the FID data to identify restricted indirect, unrestricted indirect, Medicaid indirect, and direct costs from 2013-2014. The adjusted numbers will then be transferred to the indirect cost rate carryforward computation. If your district did not negotiate a rate for 2013-2014 or negotiated a zero rate, no carryforward adjustment will be allowed. The fixed carryforward will be zero, and the adjusted indirect costs will be the same as indirect costs as adjusted by the DS-4513.

If your district had an indirect rate above the corresponding cap in 2013-2014, it is ineligible for any underrecovery adjustment to the corresponding 2013-2014 indirect cost pool.

The carryforward calculation is meant to adjust the current indirect cost rates by amounts over or under recovered in the second preceding year, except when the rate exceeded the cap in that year. It compares the actual direct cost base to the estimated direct cost base and the actual indirect costs to the

estimated indirect costs. The amount of over or under recovery from 2012-2013 remains static and is included in the calculation. Adjustments are made to the indirect cost pool for 2015-2016 to increase or decrease the current rate accordingly.

6. Part III: Certification: Districts must certify that the information provided is correct and prepared in compliance with state and federal guidance. They must also attest that costs are treated in a consistent manner and that no costs that have been incurred for a federally-supported project or grant are included in the indirect cost pool. The superintendent or chief operating officer is generally the responsible official.
7. Forward the forms to the Department of Education: Upon completion, please forward form DS-4513 and supporting worksheets to:

Michigan Department of Education
Office of State Aid and School Finance
ATTN: Phil Boone
P.O. Box 30008
Lansing, MI 48909

As an alternative, you may either fax form DS-4513 and supporting worksheet to (517) 241-0196 ATTN: Phil Boone, or attach them to an e-mail to boonep2@michigan.gov.

NOTE: If you choose to submit by e-mail you must include the following statement in the body of the e-mail in addition to your name, title, and contact information:

"I hereby certify as the responsible official of said school district that the information contained in this indirect cost rate adjustment is correct and was prepared in accordance with state and federal requirements subject to specific grant limitations. I further certify that a consistent approach has been followed in treating a given type of cost as direct or indirect, and that in no case have costs of federally supported programs been included in the indirect costs reflected in this adjustment."

Completed forms are due on or before June 1, 2015. You will not be notified directly of your final indirect cost rates by the Department. Instead the preliminary R0418 published on the MDE website will be replaced with a final R0418. A note will be included in the State School Aid Update when the R0418 has been updated. The preliminary rate may be utilized until such time as the final rate is published.

Other Information:

1. Michigan schools indirect cost rates are "fixed" rates, meaning the rates are based upon previous year's activity and a carryforward amount is included in the calculation to adjust the rates for actual results. While the calculation for the carryforward is cumbersome, it is necessary to comply with U.S.

Department of Education requirements.

2. Records and documentation supporting the indirect cost proposal must be retained for a period of five years after the last day of the fiscal year to which the proposal applies.
3. Account for the recovery of indirect costs using fund modification function 6xx, in order to bill the grant without affecting actual cost data. See detailed instructions and examples at http://www.michigan.gov/documents/Accounting_for_the_Recovery_of_Indirect_Cost_64358_7.pdf.

Questions or Comments:

Your questions and concerns regarding indirect cost rates are welcome. Please contact Phil Boone at (517) 335-4059 or e-mail at boonep2@michigan.gov.