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A. Introduction

There are several methods for allocating indirect cost/expenses to projects, activities and programs. For applicants who have prior experience in developing Indirect Rates, **Paragraph B** identifies the most comprehensive tool. The instructions in **Paragraphs C and D** below are provided as a **sample** for recipients who have little or no experience in developing indirect rates but intend to request reimbursement for indirect costs as part of a Federal Financial Assistance Award. Select one method for Paragraph A, B, or C. The resulting Indirect Rates are needed on two occasions:

1. **Initially, indirect rates will be required for estimating the Budget** for a current or pending award if indirect costs are requested for reimbursement.
2. **After the award** is made, the applicant will provide actual trued up indirect rates on an annual basis to the Specialist at the awarding office to **reconcile billed costs based on budgeted rates to actual costs** per the award terms and conditions.

Paragraph E below contains terms and references that may be unfamiliar to a new applicant but that are essential in understanding how to develop an Indirect Rate.

B. Indirect Rate Proposal – DCAA "ICE" model

For applicants who have prior experience in calculating Indirect Rates, the most comprehensive instruction with sample schedules/spreadsheet is the Defense contract Audit Agency's (DCAA) Incurred Cost Electronic (ICE) model. The model can be located on the DCAA website at **http://www.dcaa.mil/** under **DCAA Publications, ICE Model.** Although the ICE model is intended as a sample for accumulating Annual Incurred Cost it can also be used as a model in forecasting indirect rates.

C. Indirect Rate Proposal – Single Rate Method – Example

The following is a sample INDIRECT RATE PROPOSAL using the single Rate Method. The Indirect Rate Calculations and Step by Step instructions are shown below the General Ledger Table. Each Step has a narrative explanation provide on page 3.

GENERAL LEDGER

ACCT #	ACCOUNT NAME	INUAL TOTAL	DIRECT	INDIRECT	UNALLOW	INDIRECT-CLAIMED
6110	*Salaries and Wages*	$ 656,824	$ 656,824			
8110	*Salaries and Wages*	$ 123,067		$ 123,067		$ 123,067
8210	*Holiday*	$ 22,502		$ 22,502		$ 22,502
8211	*Vacation*	$ 31,252		$ 31,252		$ 31,252
8212	*Sick Leave*	$ 15,318		$ 15,318		$ 15,318
8213	*Severence Pay*	$ 32,419		$ 32,419		$ 32,419
8214	*FICA-Employer Portion*	$ 27,427		$ 27,427		$ 27,427
8215	*Federal Unemployement Insura*	$ 1,393		$ 1,393		$ 1,393
8216	*State Unemployment Insurance*	$ 6,722		$ 6,722		$ 6,722
8217	*Workers' Compensation*	$ 3,826		$ 3,826		$ 3,826
8218	*Health Insurance*	$ 40,009		$ 40,009		$ 40,009
8219	*Life Insurance*	$ 7,920		$ 7,920		$ 7,920
8220	*Pension Plan*	$ 60,638		$ 60,638		$ 60,638
8221	*Recruitment*	$ 285		$ 285		$ 285
8222	*Relocation*	$ 1,216		$ 1,216		$ 1,216
8223	*Personal Absence*	$ 1,082		$ 1,082		$ 1,082
6310	*Travel*	$ 35,173	$ 35,173			
8310	*Travel*	$ 12,987		$ 12,987	$ 2,500	$ 10,487
6320	*Material*	$ 843,192	$ 843,192			
6330	*Other Direct Cost*	$ 187,493	$ 187,493			
6340	*Subcontracts-contractual*	$ 944,841	$ 944,841			
6350	*Supplies*	$ 25,000	$ 25,000			
8350	*Supplies*	$ 15,014		$ 15,014		$ 15,014
6360	*Equipment Rental*	$ 15,000	$ 15,000			
8360	*Equipment Rental*	$ 12,150		$ 12,150		$ 12,150
8410	*Legal Fees*	$ 1,744		$ 1,744		$ 1,744
8420	*Audit Fees*	$ 32,361		$ 32,361		$ 32,361
8430	*Miscellaneous*	$ 3,969		$ 3,969		$ 3,969
8503	*Entertainment*	$ 484		$ 484	$ 484	$ -
8505	*Advertising & Promotion*	$ 354		$ 354		$ 354
8520	*Periodicals*	$ 6,435		$ 6,435		$ 6,435
8522	*Bad Debts*	$ 3,018		$ 3,018	$ 3,018	$ -
8523	*Business Meals*	$ 2,702		$ 2,702		$ 2,702
8524	*Depreciation/Amortization*	$ 2,824		$ 2,824		$ 2,824
8525	*Dues/Memberships*	$ 2,112		$ 2,112		$ 2,112
8526	*Conventions/Seminars*	$ 7,936		$ 7,936	$ 2,000	$ 5,936
8527	*Interest Expense*	$ 1,001		$ 1,001	$ 1,001	$ -
8531	*Insurance*	$ 738		$ 738		$ 738
8535	*Repairs/Maintenance*	$ 1,681		$ 1,681		$ 1,681
8537	*Telecopier*	$ 2,434		$ 2,434		$ 2,434
8539	*Telephone*	$ 45,552		$ 45,552		$ 45,552
8539	*Temp Help/contract labor*	$ 1,816		$ 1,816		$ 1,816
8540	*Small Equipment*	$ 878		$ 878		$ 878
8542	*Postage & Handling*	$ 6,235		$ 6,235		$ 6,235
8553	*Office Supplies*	$ 6,461		$ 6,461		$ 6,461
8554	*Other Outside Services*	$ 30,281		$ 30,281		$ 30,281
	TOTAL		$ 2,707,523	$ 576,243	$ 9,003	$ 567,240
			Base-Direct Labor			Pool
	INDIRECT COST POOL	$ 567,240				
	BASE= (DIRECT LABOR)	$ 656,824				
	INDIRECT RATE	**86.40%**				

STEPS IN SINGLE RATE PROCESS

1. Develop List of Accounts (GL)
2. Segregate Direct Cost from Indirect Costs
3. Segregate Unallowable Costs
4. Consider Adjustments to Historical Cost
5. Sum the Indirect Cost Pool
6. Identify the Indirect Base
7. Calculate the Indirect Rate

D. Indirect Rate Proposal – Single Rate Method- Written Narrative

The following is a written narrative to explain the Steps identified in the Single Rate Method Example on Page 2. The simplified method for allocating indirect costs is the Single Rate Method. This is usually applicable to a small business with less than $10M or less than 25 employees. This method groups all allowable indirect costs, including fringe, into a single pool. The following is a step-by-step process of how to use the information from your General Ledger (GL) to develop an indirect rate.

1. Develop List of Accounts (General Ledger)

Start the process by compiling a list of all accounts in the GL, along with the Account Number, Account Name and the Dollars that equate to the most recent fiscal year of incurred costs/expenses. If the business is new and no costs/expenses have been incurred, then use your best judgment in estimating cost of budgeted amounts for the accounts in the General Ledger. **(A GL sample is included following step 8 below.** Please note that it is provided only as a sample and therefore the recipient should use their own account names and numbers rather than those in the sample.)

2. Segregate Direct Costs from Indirect

The second step in the process is to determine which accounts/costs in the GL can be considered direct costs to a single project or indirect costs to two or more projects (see definitions in paragraph E). Evaluate each expense or account in the GL to determine if the account should be divided into separate direct and indirect accounts. For example, Salaries and Wages can be charged as a direct cost in some situations and as an indirect cost in other situations. Therefore, Salaries and Wages would be separated into two distinct account numbers in the GL to separate direct salaries from indirect salaries (as shown in the example GL following Step 8 below). Other similar cost/expenses that may be identified as sometimes direct and sometimes indirect are travel, supplies, equipment and subcontracts. Costs that are identified as direct in the GL must track in corresponding subsidiary ledgers with unique account numbers to each project or job. For example, direct salaries /labor can be accumulated into one direct account number in GL, but in the subsidiary ledgers the direct salaries must be identified to individual projects using unique account numbers. To be considered compliant, the government requires a job order cost accounting system.

3. Segregate unallowable Costs

Once the costs in the GL are separated into direct and indirect accounts, you must identify any cost that may be considered unallowable for Federal awards and remove them from the total indirect cost pool. Unallowable costs are identified in the cost principles for each type of organization (see Reference Information in paragraph E). It is essential to read the appropriate Cost Principles to identify the types of costs that are considered unallowable. In some situations costs might be considered allowable where the same type of cost can be considered unallowable in other circumstances. The sample GL following Step 8 below identifies some unallowable costs. The sample is not a complete list.

4. Consider Adjustments to Historical Expenses

As explained in the Introduction there are two situations for which the recipient will be preparing an Indirect Rate Proposal. Item 2 in the Introduction was for when you have an existing Award and you must annually submit a fiscal year indirect Rate proposal as required by the terms and

conditions of an existing Award. In that situation, the historical expenses accumulated in Step 1 must be those that are used to develop the indirect Rate in Step 7. However, if the recipient is preparing an Indirect Rate Proposal for a pending/current Award then the recipient needs to consider the impact the pending Award will have on their financial status (General Ledger). In some cases the historical cost accumulated as part of Step 1 may need to be adjusted to better reflect the financial situation for the pending Award. As an example, if all expenses in the General Ledger will increase in the same proportion there would be no impact on the resulting Indirect Rate result calculation in step 7. However if direct labor goes up significantly but other indirect expenses do not increase in proportion the result would be a decrease to the Indirect Rate calculated in Step 7. Therefore the recipient preparing the Indirect Rate Proposal should perform a cursory review of the nature and magnitude of the accumulated historical expenses and make appropriate adjustments to ensure that the resulting Indirect Rate is the best representation of your business during the period of performance of the current Award. If historical costs are adjusted to accommodate better business judgment then please provide the original historical cost, the adjusted costs and a written descriptive summary of the business assumptions used in determining the adjusted costs when submitting the Indirect Rate Proposal.

5. Sum the Total of the Indirect Cost Pool (numerator)

Add the total of all allowable indirect costs that are segregated in step 3 above. This will be the "pool" or top number (numerator) when dividing to compute the indirect rate. Please ensure that there are no unallowable costs included

6. Select the Base – federal and non-federal (denominator)

The base used to allocate the indirect costs is usually Total Direct Labor or Total Direct Costs of all projects/programs/activities. In the attached example, Total Direct Labor Costs is used as a base. Therefore, simply identify the direct labor costs (both federal and non-federal projects) that are segregated in step 2 above. This will be the "base" of allocation or the bottom number (denominator) for calculating the indirect rate. Normally there are no unallowable direct costs but please note that if here are any they need to be left in the total base cost so that the indirect costs are allocated equitably.

7. Calculate the Indirect Rate (Pool/Base)

Divide the Pool amount in step 5 by the base amount in step 6. This will be the Indirect Rate as a percentage of the base selected. Indirect Cost is identified in the Budget (form SF-424a) in block 6j.

D. Indirect Rate Proposal – Two Rate Method (Fringe Rate and Indirect Rate)—Example

The following is a sample INDIRECT RATE PROPOSAL using the two rate method- Sample rate calculations are included below the General Ledger with a Step by Step process. A written narrative of each step is provided on Page 6 following the example.

GENERAL LEDGER

ACCOUNT #	ACCOUNT NAME	ANNUAL TOTAL	DIRECT	FRINGE	INDIRECT	UNALLOWABLE	INDIRECT-CLAIMED
8210	Holiday	$ 22,502		22502			
8211	Vacation	$ 31,252		31252			
8212	Sick Leave	$ 15,318		15318			
8213	Severence Pay	$ 32,419		32419			
8214	FICA-Employer Portion	$ 27,427		27427			
8215	Federal Unemployement Insurance	$ 1,393		1393			
8216	State Unemployment Insurance	$ 6,722		6722			
8217	Workders' Cmpensation	$ 3,826		3826			
8217	Health Insurance	$ 40,009		40009			
8219	Life Insurance	$ 7,920		7920			
8220	Pension Plan	$ 60,638		60638			
TOTAL FRINGE POOL				**$ 249,426**			
6110	Salaries & Wages	$ 656,824	$ 656,824				
8110	Salaries & Wages	$ 123,067			123067		$ 123,067
	FRING ALLOCATED TO DIRECT & INDIRECT LABOR		**$ 210,184**	32%	**$ 39,381**		$ 39,381
8221	Recruitment	$ 285			$ 285		$ 285
8222	Relocation	$ 1,216			$ 1,216		$ 1,216
8223	Personal Absence	$ 1,082			$ 1,082		$ 1,082
6310	Travel	$ 35,173	$ 35,173				
8310	Travel	$ 12,987			$ 12,987	$ 2,500	$ 10,487
6320	Material	$ 843,192	$ 843,192				
6330	Other Direct Cost	$ 187,493	$ 187,493				
6340	Subcontracts-contractual	$ 944,841	$ 944,841				
6350	Supplies	$ 25,000	$ 25,000				
8350	Supplies	$ 15,014			$ 15,014		$ 15,014
6360	Equipment Rental	$ 15,000	$ 15,000				
8360	Equipment Rental	$ 12,150			$ 12,150		$ 12,150
8410	Legal Fees	$ 1,744			$ 1,744		$ 1,744
8420	Audit Fees	$ 32,361			$ 32,361		$ 32,361
8430	Miscellaneous	$ 3,969			$ 3,969		$ 3,969
8503	Entertainment	$ 484			$ 484	$ 484	0
8505	Advertising & Promotion	$ 354			$ 354		$ 354
8520	Periodicals	$ 6,435			$ 6,435		$ 6,435
8522	Bad Debts	$ 3,018			$ 3,018	$ 3,018	0
8523	Business Meals	$ 2,702			$ 2,702		$ 2,702
8524	Depreciation/Amortization	$ 2,824			$ 2,824		$ 2,824
8525	Dues/Memberships	$ 2,112			$ 2,112		$ 2,112
8526	Conventions/Seminars	$ 7,936			$ 7,936	$ 2,000	$ 5,936
8527	Interest Expense	$ 1,001			$ 1,001	$ 1,001	0
8531	Insurance	$ 738			$ 738		$ 738
8535	Reparis/Maintenance	$ 1,681			$ 1,681		$ 1,681
8537	Telecopier	$ 2,434			$ 2,434		$ 2,434
8538	Telphone	$ 45,552			$ 45,552		$ 45,552
8539	Temp Help/contract labor	$ 1,816			$ 1,816		$ 1,816
8540	Small Equipment	$ 878			$ 878		$ 878
8542	Postage & Handling	$ 6,235			$ 6,235		$ 6,235
8553	Office Supplies	$ 6,461			$ 6,461		$ 6,461
8554	Other Outside Services	$ 30,281			$ 30,281		$ 30,281
TOTAL INDIRECT COST POOL							
TOTALS			$ 2,917,707		$366,198	$9,003	$357,195
			(BASE)				(POOL)
	FRINGE COST POOL	**$249,426**	INDIRECT COST POOL			$357,195	
	BASE (DIRECT & INDIRECT LABOR)	$779,891	BASE=(TOTAL DIRECT COSTS)			$ 2,917,707	
	FRINGE RATE	32.0%		**INDIRECT RATE**		12.2%	

STEPS IN THE TWO RATE METHOD

1. Develop List of Accounts (GL)
2. Segregate Direct Costs, Fringe costs and Indirect Cost
3. Segregate Unallowable Costs
4. Consider Adjustments to Historical Costs
5. Identify Fringe Pool
6. Identify Fringe Base
7. Compute the Fringe Rate
8. Distribute Fringe Expense (direct and indirect)
9. Sum the Indirect Cost Pool
10. Identify the Indirect Cost Base
11. Calculate the Indirect Rate

D. Indirect Rate Proposal – Two Rate Method (Written Narrative)

The following is a written narrative to explain the steps identified in the Example on page 5. Paragraph C discusses the **simplified** method for calculating an indirect rate but the **more common** approach is to develop two indirect rates, one for Fringe and a separate Indirect Rate. The only difference from Paragraph C is that the costs are separated into three categories instead of two. The two mentioned in Paragraph C were Direct and Indirect Costs. In the two-rate method the Fringe Costs are separated out of the other indirect cost in the General Ledger (GL) to create a Fringe Pool of their own.

1. Same as Step 1 in Paragraph C

2. **Segregate Direct Costs from Fringe and Indirect Cost**
   The second step in the process is to determine which accounts/costs in the GL into three categories, direct costs, fringe costs, or indirect costs. First, separate out what would be considered employee benefits or fringe costs and then use the same scenario described in paragraph C-2 above to determine direct and indirect costs after the fringe is separated.

3. **Same as Step 3 in Paragraph C.**

4. **Same as Step 4 in Paragraph C.**

5. **Identify the Fringe Pool (numerator)**
   As described in step 2, the GL cost elements must be separated into three cost groupings/pools. As seen in the sample GL below, the first grouping of costs could be the Fringe pool which will include the expenses incurred by the business for the employees such as FUTA, SUTA, employer share of social security taxes, health insurance/medical, etc. Add the total of these costs to determine the Fringe Pool.

6. **Identify the Fringe Base (denominator)**
   The base for allocating Fringe will be the total of direct and indirect Salary and Wages.

7. **Compute the Fringe Rate**
   Divide the total from Step 5 by the total from Step 6. This will be the Fringe Rate which will be applied to both direct and indirect salaries and wages (total labor cost).

8. **Distribute the Fringe Expense to Direct and Indirect Columns**
   The Fringe rage calculated in Step 7 can now be used to distribute or allocate the fringe expense to the Direct and Indirect Expense Columns. Use the calculated Fringe Rate from Step 7 and multiply the amount of total Direct Labor dollars. Manually enter the amount in the Direct Expense column of the General Ledger. This fringe amount will now be considered part of the Total Direct Costs. In preparing a Budget (SF-424a) the computed Fringe Rate will be multiplied times the amount of Direct Labor in Block 6a and the amount entered in Block 6b. Similarly, multiply the Fringe Rate computed in Step 7 by the indirect Labor dollars. Manually enter the amount in the Indirect Expense column in the General Ledger. The Fringe in the Indirect Expense column will now become part of the "indirect pool" described in Step 9.

9. Sum the Indirect Pool (numerator)

Add the total of all allowable indirect costs that are segregated in step 3 above. This will be the "pool" or top number (numerator) when dividing the compute the indirect rate. Please ensure that there are no unallowable costs included or any costs in the indirect Cost Pool that are also claimed in the base in Step 5. Also note that the Indirect Pool includes the fringe computed on indirect labor in Step 8.

10. Identify the indirect cost base (denominator)

The base or denominator for computing the indirect rate is commonly Direct Labor which was used in this example. Other bases such as Total Direct Costs can also be used if appropriate.

11. Definitions and References

DIRECT COSTS- Direct Costs are those costs that can be identified and traced to a single project, activity, function, program, job or contract. Examples of costs that are most easily traced to a specific project are labor, equipment, subcontracting, supplies, and other direct costs. For accounting purposes, the General Ledger would accumulate all direct costs into summary accounts such as Direct Labor, Direct Material, etc., but the subsidiary ledgers would have unique account identifiers to track the costs to the specific projects.

INDIRECT COSTS- Indirect costs are those costs or expenses that cannot be identified or tracked to a single activity, project, job, or contract or costs that apply to more than one project. Some examples of the types of cost that typically might be considered indirect are clerical labor, supervisor/management labor, utilities, phone expenses, fringe benefits, insurance, legal, and office rental or mortgage. These costs will be allocated or spread to more than 1 project.

ALLOCATE- Allocate means to set apart or assign. Direct costs are assigned or allocated to individual projects based on an equitable base such as direct labor. Indirect costs are set apart or allocated to two or more projects.

BASE (denominator) - Indirect costs are assigned or allocated to individual projects by using an Indirect Rate. The number that the rate or percentage will be applied to the "base". Therefore if an indirect rate is going to be applied to a project then the "base" has to be something that is a directly identified to the project such as direct labor hours, direct labor dollars, material, supplies etc. One concern becomes in how to know what "base" to use when computing an indirect rate. To make the determination, two things should be considered. First, who or what causes the indirect cost and secondly, who or what benefits from the indirect cost? For example the paying of salaries and wages causes a business to have to incur fringe costs so the most logical base to use for computing a fringe rate is salary and wages. Other indirect costs such as utilities are not caused by any single person or event but everything in the business benefits from paying the utilities so the base could be all direct labor costs or total direct costs since they all benefit.

INDIRECT COST POOL (numerator) - Indirect costs can not be identified to specific projects; so all the indirect costs are grouped or added together into an indirect cost pool. By combining the costs into one pool, the costs can be allocated to projects by computing an indirect rate after a base is selected. Examples of indirect cost that can be combined into one group are fringe costs that are grouped into a "fringe pool".

INDIRECT RATE- An indirect rate is simply a mathematical calculation expressed as a percentage that results from dividing the allowable indirect cost pool dollars by the selected direct base dollars. When expressing an Indirect rate it is always important to express both the percentage and the base to which it applies (e.g. 45% of TDC). Expressing that an Indirect rate as 45% doesn't mean anything unless it's also states the base that it is applied to such as Total Direct Labor or Total Direct Costs.

UNALLOWABLE COSTS- Federal guidelines prohibit the Federal Government form reimbursing certain types of costs that are called unallowable. Allowable and unallowable costs are listed in the corresponding cost principles for each type of organization. The references below identify the cost principles that are applicable to unallowable in part because of the nature of way they were incurred.

REFERENCE INFORMATION

- For DOE Financial Assistance Regulations refer to **10 CFR 600.** Financial Administration is addressed in Parts 600.120-128, 220-226 and 310-318.
- For information associated with **Cost Principles** defining allowable and unallowable costs for different types of organizations refer to the following:
    1. Commercial Organizations: **Federal Acquisition Regulation (FAR) Part 31.**
    2. Educational Institutions: OMB Circular **A-21**
    3. State, Local, & Indian Tribe Governments: OMB Circular **A-87**.
    4. Non-Profit Organizations: OMB Circular **A-122**
- For audit requirements for States, Local Governments, and Non Profit Organizations including Institutions of Higher Education, refer to OMB Circular **A-133**.
- Administrative requirements are found in OMB Circular **A-102** and **A-110**.