



Indirect Costs: Uses, Responsibilities and Restrictions

What are Indirect Costs and Who Calculates the Rate?

Indirect costs (IDCs) represent the expenses of doing business that are not readily identified with a particular grant, contract, project, function, or activity but are necessary for the general operation of the Local Education Agency (LEA) and the conduct of activities it performs. Direct costs, by contrast, are those costs which can be easily, obviously, and conveniently identified with specific activities or programs.

An indirect cost rate (ICR) represents the ratio between the total indirect cost and benefiting direct costs, after excluding and or reclassifying unallowable costs and extraordinary or distorting expenditures (e.g., capital expenditures and major contracts and subgrants). These exclusions and distorting items are discussed in the sections below.

CDE's School Finance Unit (SFU) annually calculates each LEA's ICR based on an LEA's Finance December Data Collection (data submission) captured via Data Pipeline. Please visit this [SFU webpage](#) to understand how an LEA's Fixed with Carry Forward Indirect Cost Rate is calculated.

Note, the Fixed with Carry-Forward indirect cost calculation method used to determine both an LEA's Restricted and Non-restricted rates (based on the December data submission) is reviewed and approved by the U.S. Department of Education every four years.

Exclusions and Distorting Expenditures

The indirect cost calculation performed by SFU as indicated above starts with an LEA's total direct costs and then removes any distorting items, either in whole or in part, to arrive at what is known as the Modified Total Direct Costs (MTDC) for an LEA. The Uniform Grant Guidance (UGG) defines MTDC at [2 CFR 200.1](#) as:

“...all direct salaries and wages, applicable fringe benefits, materials and supplies, services, travel, and up to the first \$50,000 of each subaward [contract] (regardless of the period of performance of the subawards under the award). MTDC excludes equipment, capital expenditures, charges for patient care, rental costs, tuition remission, scholarships and fellowships, participant support costs, and the portion of each subaward [contract] in excess of \$50,000 ...”

Equipment and capital expenditures are fully excluded from the indirect cost calculations because they tend to be distorting in nature.

- Equipment is defined as tangible personal property having a useful life of more than one year and a per-unit acquisition cost equal to or exceeding the lesser of the capitalization level established by the LEA for financial statement purposes, or \$10,000 ([2 CFR 200.1](#)). Examples include the cost of equipment plus any expenditures incurred to place the equipment in service such as delivery and installation services.

Note, items with an initial individual cost that is less than \$10,000 (or the LEA's capitalization threshold) that require additional peripherals necessary for the item to be placed in service must be capitalized as equipment if the cost of the peripherals cause the overall cost of the item to meet or exceed \$10,000 or the LEA's capitalization threshold. Examples include network servers that require multiple pieces of equipment, blades, storage, etc. necessary for the server to properly function and be placed in service (i.e., the server could not work without the additional parts).

- Capital expenditures are defined as expenditures to acquire capital assets or expenditures to make additions, improvements, modifications, replacements, rearrangements, reinstallations, renovations, or alterations to capital assets that materially increase their value or useful life ([2 CFR 200.1](#)). Examples include labor and materials related to capital construction projects.

In addition, certain contracted **services** are distorting in nature, so the ICR must **only be applied against the first \$50,000** of costs associated with these contracts. The underlying rationale is that if a third party performs work under a contract to provide services for the LEA, then the LEA does not have to provide the same level of administrative support as it would if it were performing the work itself (e.g., payroll and accounting costs, supplies, management costs, overhead/facilities, etc.).

- For example, if an LEA chooses to contract with an outside vendor to provide transportation services, it does not have to handle payroll for bus drivers or the payment of invoices to a fuel supplier. Therefore, it is considered distorting for the entire cost of providing transportation to be included in the application of an ICR for the LEA.

By contrast, if an LEA contracts with a vendor to provide services augmenting current staffing (perhaps in instances where the labor pool or special skills are not available at the LEA or surrounding community), the LEA must examine the scope of work to determine the nature of its relationship with its service subcontractor and the existence of any behavioral or financial control. LEAs should utilize [IRS Tax Topic no. 762 Independent Contractor vs. Employee](#) as a helpful resource for this analysis.

- For example, if an LEA hires a tutor from a temporary service, they must examine the relationship between the tutor and the LEA to determine the degree of control and independence. The relationship becomes more akin to that of an employer/employee if the LEA can answer "Yes" to questions such as:

- Does the LEA have a right to direct and control what work is accomplished and how the work is performed, through instructions, training, or other means (i.e., behavioral control)?
- Does the LEA provide items such as workspace, supplies, and a set work schedule to the tutor/nurse, counselor, etc. (i.e., financial control)?
- Does the LEA provide the tutor with employee-type benefits, such as insurance, a pension plan, vacation pay, or sick pay (i.e., relationship of the parties)?

In these instances, the LEA does provide a similar level of administrative support for the contracted services as they would have had they provided the services themselves, so the \$50,000 exclusion would not apply.

Step-by-Step Indirect Cost Decision Tree

Step 1: Are these direct [expenditures](#) that have been charged to the grant award via the LEA's accounting system?

- Yes - move on to Step 2
- No - STOP. No indirect cost recovery is allowed per the [MTDC definition](#).

Step 2: Are these [equipment](#) or [capital expenditures](#) as defined by 2 CFR 200.1 and consistent with the LEA's internal capitalization threshold?

- Yes - STOP. No indirect cost recovery is allowed per the [MTDC definition](#).
- No - move on to Step 3

Step 3: Are these expenditures for [professional services](#) performed via a contract?

- Yes - move on to Step 4
- No - The LEA may apply its approved ICR to these direct expenditures for the year in which they were incurred. Note, each LEA has both a restricted and an unrestricted rate. See LEA Grant Award Letter (GAL) for appropriate rate.

Step 4: Based on the [MTDC definition](#) and using the [IRS Tax Topic no. 762 Independent Contractor vs. Employee](#) as a basis for analysis, does the LEA's relationship with the contractor function more like an employee/employer relationship as discussed above in the Exclusions and Distorting Expenditures section?

- Yes - The LEA may apply its approved ICR to these direct expenditures for the year in which they were incurred. Note, each LEA has both a restricted and an unrestricted rate. See LEA Grant Award Letter (GAL) for appropriate rate.
- No - The LEA may apply its approved ICR to these direct expenditures for the year in which they were incurred BUT ONLY on the first \$50,000 of each contract per the [MTDC definition](#).

ICR Uses and Reimbursement Requests

Indirect cost recovery is designed for LEAs to offset various overhead and operating costs already incurred in the general course of doing business by applying an approved ICR to the identified MTDC for the applicable award (as discussed above). Once recovered, the cash “in the door” is not restricted by any federal rules since it is merely a reimbursement of incurred expenditures.

IDCs are recovered as part of the request for reimbursement process. The IDCs calculated as described above would be included with the applicable direct costs being requested at any given time. Please note, as SFU calculates the ICR annually, the LEA must ensure the appropriate ICR is applied to MTDC from the corresponding fiscal year. For instance, the ICR approved for use in fiscal year 2024–25 would be used for expenditures incurred July 1, 2024, through June 30, 2025, and the ICR approved for use in fiscal year 2025–26 would be used for expenditures incurred from July 1, 2025, through June 30, 2026. **Remember, IDCs CANNOT be charged on expenditures that have NOT yet been incurred.**

Indirect Cost Recovery Adjustments

The automatic IDC calculations inherent in systems, such as GAINS, are based on object codes. Those calculations exclude specific object codes (e.g., 0730 Equipment and 0594 Purchased Services from Districts and Charter Schools), but the systems have no way to identify and exclude additional distorting items that are subject to the \$50,000 limitation discussed above (e.g., service contracts recorded in 0300 Purchased Professional and Technical Services). Therefore, LEAs must manually calculate their IDCs and use the override feature available in these systems, if needed, to ensure their IDCs have been properly budgeted. For a complete listing of object code and other exclusions in the SFU ICR calculations, LEAs can find their specific *Indirect Cost Report* by fiscal year in the Indirect Cost Rate Calculations section of the [SFU webpage](#).

If errors are discovered either by the LEA’s manual calculation discussed above or by CDE staff, the LEA is expected to make the necessary adjustments in their accounting systems to ensure compliance. Should these adjustments result in additional funds from a specific program, the LEA must submit a Post Award Revision (PAR) to identify other allowable costs to account for the difference. Replacement activities and costs must be allowable under the impacted programs, reasonable, and necessary to meet the program intent (i.e., be allocable to the impacted program).

Calculations and Entries Using the Revenue or Abatement Method

LEAs may record their IDCs using either the Revenue Method or the Abatement Method. The CDE Grants Fiscal Management Unit (GFMU) and SFU have put together the examples in the following tables using an assumed 10.5% ICR as follows:

- Table 1 Initial MTDC and IDC Calculation – This table shows the initial calculation of MTDC and the related IDCs, and it identifies the errors within the calculation.

- Table 2 Initial Revenue Method Entries – This table shows the Revenue Method entries used to record the IDCs calculated in Table 1
- Table 3 Initial Abatement Method Entries – This table shows the Abatement Method entries use to record the IDCs calculated in Table 1
- Table 4 Corrected Indirect Cost Calculation – This table shows the corrected calculations of MTDC and IDCs (to remove IDCs charged on object 0730 and the amount of a contract in excess of \$50k)
- Table 5 Revenue Method Correcting Entries – This table shows the Revenue Method entries to correct the IDCs recorded in Table 2.
- Table 6 Abatement Method Correcting Entries – This table shows the Abatement Method entries to correct the IDCs recorded in Table 3

Table 1 Initial MTDC and IDC Calculation

Description	Amount	Comment
Travel (e.g., object 0580)	6,000	
Purchased Services (e.g., object 0300)	55,000	Error: Only up to \$50k per contract by grant
Supplies (e.g., object 0610)	3,000	
Equipment (e.g., object 0730)	12,000	Error: No IDCs on capital expenditures
Total	76,000	
ICR	10.5%	
Total IDC initially charged	7,980	Includes capital expenditures and full amount of contract (amounts in excess of \$50k) in error

Table 2 Initial Revenue Method Entries

Debit/Credit Title	Account String	Amount
DR Indirect Exp	22-XXX-00-XXXX-0869-XXX-4010	7,980
CR Pooled Cash	22-XXX-00-XXXX-8100-XXX-0000	7,980
DR Pooled Cash	10-XXX-00-XXXX-8100-XXX-0000	7,980
CR Revenue	10-000-00-0000-1972-000-0000	7,980

Table 3 Initial Abatement Method Entries

Debit/Credit Title	Account String	Amount
DR Indirect Exp	22-XXX-00-XXXX-0869-XXX-4010	7,980
CR Pooled Cash	22-XXX-00-XXXX-8100-XXX-0000	7,980
DR Pooled Cash	10-XXX-00-XXXX-8100-XXX-0000	7,980
CR Indirect Exp	10-000-00-0000-0869-000-0000	7,980

Table 4 Correcting MTDC and IDC Calculation

Description	Amount	Comment
Travel (e.g., object 0580)	6,000	
Purchased Services (e.g., object 0300)	50,000	Correction: Only up to \$50k per contract by grant – reduced by \$5k to get to \$50k
Supplies (e.g., object 0610)	3,000	
Equipment (e.g., object 0730)	0	Correction: No IDCs on capital expenditures – reduced by \$12k to get to zero
Total	59,000	
ICR	10.5%	
Total allowable IDCs	6,195	Corrected amount
Total IDCs initially charged	7,980	Includes capital expenditures and full amount of contract (amounts in excess of \$50k) in error
Difference	1,785	

Table 5 Correcting Revenue Method Entries

Debit/Credit Title	Account String	Amount
DR Pooled Cash	22-XXX-00-XXXX-8100-XXX-0000	1,785
CR Indirect Exp	22-XXX-00-XXXX-0869-XXX-4010	1,785
DR Revenue	10-000-00-0000-1972-000-0000	1,785
CR Pooled Cash	10-XXX-00-XXXX-8100-XXX-0000	1,785

Table 6 Correcting Abatement Method Entries

Debit/Credit Title	Account String	Amount
DR Pooled Cash	22-XXX-00-XXXX-8100-XXX-0000	1,785
CR Indirect Exp	22-XXX-00-XXXX-0869-XXX-4010	1,785
DR Indirect Exp	10-000-00-0000-0869-000-0000	1,785
CR Pooled Cash	10-XXX-00-XXXX-8100-XXX-0000	1,785

Note, if a district is reporting the grant activity in Fund 10, the pooled cash accounts in the entry will net to zero since all entries will be in Fund 10. If the indirect cost is in a prior fiscal year and there is nothing against which to net the indirect cost, the negative indirect expenditure will create an issue with the Data Pipeline. LEAs must inform SFU of any negative indirect expenditures and their cause so that next steps can be discussed and SFU can “release” the error.