

APPENDIX E

SAMPLE INDIRECT COST PROPOSAL FORMAT – SIMPLIFIED METHOD

This Appendix illustrates the development of an indirect cost rate under the Simplified Method described in Section H. of Circular A-21. The illustration includes two schedules. Schedule 1 shows the expenditures in the institution's financial statements and the reclassifications commonly required to recast the data in the financial statements into the classifications needed to compute an indirect cost rate under the Simplified Method. Schedule 2 shows a number of additional adjustments to the data in the financial statements, the classification of the adjusted costs as direct or indirect, and the computation of the indirect cost rate. The reclassifications and adjustments shown in the schedules are explained in notes to the schedules.

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Schedule 1

RECLASSIFICATION OF EXPENDITURES SHOWN IN FINANCIAL STATEMENTS

Expenditure Classifications (Note A)	Expenditures Per Fin. Stmts.			Reclassifications (Note B)			Reclassified Expenditures		
	Salaries & Wages	Other	Total	Salaries & Wages	Other	Total	Salaries & Wages	Other	Total
Instruction	\$ 7,300,000	\$ 1,600,000	\$ 8,900,000	\$ (180,000)	\$ (45,000)	\$ (225,000) (1)	\$ 7,120,000	\$ 1,555,000	\$ 8,675,000
Research	1,300,000	700,000	2,000,000				1,300,000	700,000	\$ 2,000,000
Public Service	300,000	200,000	500,000				300,000	200,000	\$ 500,000
Academic Support	800,000	300,000	1,100,000	(800,000)	(300,000)	(1,100,000) (2)			
Institutional Support	2,100,000	500,000	2,600,000	(2,100,000)	(500,000)	(2,600,000) (3)			
Student Services	1,300,000	750,000	2,050,000				1,300,000	750,000	\$ 2,050,000
Operation & Maintenance	600,000	2,000,000	2,600,000				600,000	2,000,000	\$ 2,600,000
Scholarships and Fellowships		1,200,000	1,200,000					1,200,000	\$ 1,200,000
Auxiliary Enterprises	1,800,000	2,250,000	4,050,000		(350,000)	(350,000) (4)	1,800,000	1,900,000	\$ 3,700,000
General Admin. And General Services				1,840,000	510,000	2,350,000 (3)	1,840,000	510,000	\$ 2,350,000
					350,000	350,000 (4)	-	350,000	\$ 350,000
Library				520,000	210,000	730,000 (2)	520,000	210,000	\$ 730,000
Departmental Administration				180,000	45,000	225,000 (1)	180,000	45,000	\$ 225,000
				30,000	5,000	35,000 (2)	30,000	5,000	\$ 35,000
Computer Center				194,000	(109,000)	85,000 (3)	194,000	(109,000)	\$ 85,000
Other Direct Costs				250,000	85,000	335,000 (2)	250,000	85,000	\$ 335,000
				66,000	49,000	115,000 (3)	66,000	49,000	\$ 115,000
					50,000	50,000 (3)		50,000	\$ 50,000
Totals	\$ 15,500,000	\$ 9,500,000	\$ 25,000,000	\$ -	\$ -	\$ -	\$ 15,500,000	\$ 9,500,000	\$ 25,000,000

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NOTES TO SCHEDULE 1

- A. The expenditure classifications shown in the financial statements conform to the classifications recommended in “College and University Business Administration” published by the National Association of College and University Business Officers and incorporated into the audit guide “Audits of Colleges and Universities” published by the American Institute of Certified Public Accountants.
- B. To compute an indirect cost rate under the simplified method in Circular A-21, a number of reclassifications are usually needed to recast the data in the financial statement into the classifications required by the Circular. The reclassifications commonly required are shown in Schedule 1 and described more fully below.

1. Reclassification of Costs Classified As Instruction in Financial Statements

Cost Item	A-21 Classification	A-21 Section	Amount
-20% of the salaries and expenses of department heads	Departmental Administration	H.2.b.(4)	\$ 225,000
Total Transfer from Instruction			\$ 225,000

2. Reclassification of Academic Support Costs

Cost Item	A-21 Classification	A-21 Section	Amount
-20% of the salaries and expenses of deans	Departmental Administration	H.2.b.(4)	\$ 35,000
-Library expenses	Library	H.2.b.(3) F.8.a.	\$ 730,000
-Other Academic Support Costs *	Direct Costs	**	\$ 335,000
Total Transfers from Academic Support			\$1,100,000

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* These costs would include any Academic Support Costs which do not qualify as allowable indirect costs (e.g., museums and galleries, course and curriculum development, demonstration schools, audio-visual services, computer assisted instruction, etc.)

** The simplified method in Section H of Circular A-21 identifies the specific costs which are allowable as indirect costs and requires that all other costs be treated as direct costs. Therefore, any cost which does not qualify as an allowable indirect cost must be classified as a direct cost. In the interest of simplicity, all of these costs may be classified as “Other Direct Costs”.

3. Reclassification of Institutional Support Costs

Cost Item	A-21 Classification	A-21 Section	Amount
-Unallowable Activities*	Direct Costs		\$ 115,000
-Catalogs, commencements and convocations	Direct Costs		\$ 50,000
-Computer Center**	Computer Center	J.44	\$ 85,000
-Other Institutional Support costs	General Admin. And General Expenses	H.2.b.(1) F.5.a.	\$2,350,000
Total Transfers from Institutional Support			\$2,600,000

* “Unallowable activities” are activities whose costs are unallowable under Section J. of Circular A-21. Examples of these activities include fund raising, investment management, alumni activities, and public relations. The treatment of “unallowable activities” differs from the treatment of other unallowable costs (e.g. bad debt expense) in that the former includes the salaries of personnel which must be included in the salary and wage distribution base in the computation of the indirect cost rate, while the latter are excluded from the rate computation entirely. The elimination of unallowable costs is shown in Schedule 2.

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** Computer centers are classified as “specialized service facilities” in Section J.44 of Circular A-21. These facilities are defined in that Section as “highly complex or specialized facilities” which provide services to an institution’s activities, such as computer centers, wind tunnels and reactors. If the costs of a facility are material, Section J.44 requires that they be treated as direct costs and be charged to users based on actual usage of the services. Paragraph (b) of Section J.44 also requires that the costs of a specialized service facility normally include its direct costs as well as its allocable share of indirect costs.

In this illustration, the institution included the direct costs of its computer center in Institutional Support Costs and reduced the costs by the revenues recorded by the Center. In order to properly establish the direct salary and wage base, the reclassification shown in Schedule 1 applies the computer center revenue to the “other costs” of the center rather than to the salaries and wages of the center. The amounts shown in Schedule 1 were computed as follows:

	Salaries and Wages	Other Costs	Total
Gross Costs of Computer Center	\$ 194,000	\$ 114,000	\$ 308,000
Less Revenues		(\$ 223,000)	(\$ 223,000)
Net Costs	\$ 194,000	(\$ 109,000)	\$ 85,000

4. Reclassification of Indirect Costs Assigned to Auxiliary Enterprises in Financial Statements

Cost Item	A-21 Classification	A-21 Section	Amount
-General Admin. And General expenses assigned to auxiliary enterprises	General Admin. And General Services		\$ 350,000
Total Transfer from Auxiliary Enterprises			\$ 350,000

**SAMPLE INDIRECT COST PROPOSAL FORMAT - SIMPLIFIED METHOD
ADJUSTMENTS AND RATE COMPUTATION**

Schedule 2

Expenditure Classifications	Reclassified Expenditures (From Schedule 1)			Adjustments		Adjusted Costs			
	Salaries & Wages	Other	Total	Salaries & Wages	Other	Direct Costs		Indirect Costs	
						Salaries & Wages	Other	Salaries & Wages	Other
Instruction	\$ 7,120,000	\$ 1,555,000	\$ 8,675,000	\$ (100,000) (A)	\$ -	\$ 7,020,000	\$ 1,555,000		
Research	1,300,000	700,000	2,000,000	(16,000) (A)	-	1,284,000	700,000		
Public Service	300,000	200,000	500,000	-	-	300,000	200,000		
Student Services Operation & Maintenance	1,300,000 600,000	750,000 2,000,000	2,050,000 2,600,000	- -	- (50,000) (B)	1,300,000	750,000	600,000	1,490,000
				-	(19,000) (C)				
				-	275,000 (D)				
				-	(391,000) (D)				
				-	(325,000) (E)				
Scholarships and Fellowships	-	1,200,000	1,200,000	-	-	-	1,200,000		
Auxiliary Enterprises General Admin. And General Services	1,800,000 1,840,000	1,900,000 860,000	3,700,000 2,700,000	(125,000) (A) (40,000) (A)	(275,000) (D) (45,000) (B)	1,675,000	1,625,000	1,800,000	804,000
				-	(11,000) (C)				
Library	520,000	210,000	730,000	-	(16,000) (B)			520,000	138,000
					(6,000) (C)				
					(50,000) (F)				
Departmental Administration	210,000	50,000	260,000	-	-			210,000	50,000
Computer Center	194,000	(109,000)	85,000		-	194,000	(109,000)		
Other Direct Costs	316,000	184,000	500,000	-	-	316,000	184,000		
Use Allowances	-	-	-	-	-				
Bldg. & Improvements	-	-	-	-	207,000 (G)			-	207,000
Equipment	-	-	-	-	70,000 (G)			-	70,000
Totals	\$ 15,500,000	\$ 9,500,000	\$ 25,000,000	\$ (281,000)	\$ (636,000)	\$ 12,089,000	\$ 6,105,000	\$ 3,130,000	\$ 2,759,000

INDIRECT COST RATE COMPUTATION

Indirect Costs	
Salaries & Wages	\$ 3,130,000
Other	<u>2,759,000</u>
Total Indirect Costs	\$ 5,889,000
Direct Salaries & Wages	\$ 12,089,000 (H)
	<u>48.7%</u>

Indirect Cost Rate: \$ 5,889,000
\$ 12,089,000

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NOTES TO SCHEDULE 2

A. Under the College Work Study Program, students may work in a number of activities at an institution. The wages paid to these students are usually included in the costs of the activities in which the students work. These wages should be treated in the following manner for purposes of computing indirect cost rates:

1. The Federal share of the wages (80%) should be eliminated from the computation.
2. The institution's share of the wages (20%) should be treated as follows:
 - If the work was performed in an indirect cost activity, the wages should be included in the appropriate indirect cost category.
 - If the work was performed on a sponsored agreement and the wages charged to the agreement, the wages should be included in the direct salary and wage base.
 - If the work was performed in a non-sponsored direct cost activity, the wages may be eliminated from the computation.

In the illustration, the students worked in instruction, research, auxiliary enterprises, and general administration (e.g. accounting office, personnel office, etc.) The exclusions shown in Schedule 2 for these wages are detailed below:

Activity	Federal Share	Institution's Share	Amount	Exclusions
Instruction (non-sponsored)	\$ 80,000	\$ 20,000	\$ 100,000	\$ 100,000
Research (sponsored)	\$ 16,000	\$ 4,000	\$ 20,000	\$ 16,000
Auxiliary Enterprises	\$ 100,000	\$ 25,000	\$ 125,000	\$ 125,000
General Admin.	\$ 40,000	\$ 10,000	\$ 50,000	\$ 40,000
TOTAL	\$ 236,000	\$ 59,000	\$ 295,000	\$ 281,000

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- B. These adjustments eliminate capital expenditures and other unallowable costs identified in section J. of Circular A-21 from the indirect cost pool. Capital expenditures include expenditures for land, buildings, equipment, and improvements which materially increase the value or useful life of land, buildings, and equipment (regardless of whether the improvements were made by outside contractors or the institution's staff.) Examples of other unallowable costs include interest expense, entertainment expense, bad debts and allowances for doubtful accounts, fines and penalties, losses on the disposition of capital assets, and losses on sponsored agreements.
- C. These adjustments reduce the costs reflected in the financial statements for "applicable credits" (e.g., purchase discounts, rebates and allowances, adjustments for overpayments or erroneous charges, etc.) as required by Section C.5. of Circular A-21. "Applicable credits" also include income generated by employee morale, health and welfare services (e.g., health services, parking services, etc.) unless the income is irrevocably set over to employee welfare organizations.
- D. Paragraph H.2.b.(2) of Circular A-21 requires an adjustment to eliminate Operation and Maintenance (O&M) expenses attributable to "other institutional activities". This adjustment should be based on a cost analysis study, a gross square footage ratio, or some other reasonable method.

In some cases, an allocation of O&M expenses to "other institutional activities" may be reflected in the institution's financial statements. If this has been done, and if the amount allocated is a reasonable approximation of the actual O&M expenses attributable to the activities, an additional adjustment to the O&M indirect cost pool is not necessary. However, the salaries and wages of "other institutional activities" might include salaries and wages allocated from O&M costs. If this is the case, the institution may exclude the allocated O&M salaries and wages from the direct salary and wage base used to compute the indirect cost rate.

If an allocation of O&M expenses to "other institutional activities" is not reflected in the financial statements, or if the amount allocated is not a reasonable approximation of the actual O&M expenses attributable to the activities, the following adjustments are necessary:

- The O&M expenses allocated to "other institutional activities" on the financial statements (if any) should be transferred back to the O&M pool.
- The proper amount of O&M expenses attributable to the activities should be computed and this amount should be removed from the pool.

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In this illustration, it has been assumed that the O&M expenses allocated to “other institutional activities” in the financial statements are not a reasonable approximation of the actual O&M expenses attributable to the activities. Therefore, the following adjustments have been made:

- The \$275,000 allocated to “other institutional activities” in the financial statements has been transferred back to the O&M pool.
 - The proper amount of O&M expenses attributable to the activities has been computed (\$391,000) and this amount has been removed from the O&M pool.
- E. In this illustration, the institution charged certain types of O&M expenses directly to sponsored agreements, but not to non-sponsored activities which received the same services. Generally accepted cost accounting principles require that costs incurred for the same purpose, in like circumstances be treated consistently as either direct or indirect costs. To meet this requirement and avoid an over-allocation of O&M expenses to sponsored agreements, an adjustment has been made to reduce O&M expenses by the approximate amount of expenses attributable to non-sponsored activities which are equivalent to those charged directly to sponsored agreements. In addition in this illustration, the direct charges to sponsored agreements were not removed from the O&M expenses shown in the financial statements. Therefore, the adjustment also includes removal of these charges from the O&M expenses.

(NOTE: The requirement for consistent treatment of costs applies to all costs – e.g., fringe benefits, telephone expenses, postage, etc.)

- F. This adjustment removes rare (museum-type) books and costs paid by a Federal library assistance grant from library expenses. Rare book purchases must be excluded from allowable library expenses under Section F.8.a. of Circular A-21. The adjustment for costs paid by the library assistance grant is necessary to preclude duplicative reimbursement of the costs.
- G. Under paragraph H.2.b.(2) of Circular A-21, depreciation or use allowances on buildings, equipment and capital improvements may be included in indirect costs. These costs, however, must be adjusted to eliminate depreciation or use allowances on assets used by “other institutional activities”. In many cases, the assets used by these activities can be readily identified and, in these cases, the adjustment should be made on that basis. If the assets cannot be readily identified, the adjustment should be based on a cost analysis study, a square footage ratio, or some other

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reasonable method. For purposes of this illustration, the allowable amount of use allowance has been computed as follows:

	Acquisition Costs – Buildings	Acquisition Costs – Equipment
Acquisition Costs Per Financial Statements	\$ 30,140,000	\$ 3,030,000
Less Adjustments For:		
Other Institutional Activities		
Dormitories	\$ 2,700,000	\$ 200,000
Cafeteria	\$ 1,035,000	\$ 290,000
Bookstore	\$ 60,000	\$ 14,000
Museum	\$ 1,200,000	\$ 164,000
Other	\$ 3,991,000	\$ 320,000
Buildings Under Construction	\$ 5,344,000	
Federally Financed Assets	\$ 3,960,000	\$ 890,000
Unused Equipment		\$ 102,000
Unused Buildings	\$ 1,500,000	
Amount Subject to Use Allowances	\$ 10,350,000	\$ 1,050,000
Use Allowance Rate	2%	6 2/3%
Total Use Allowance	\$ 207,000	\$ 70,000

- H. In this example, the direct salary and wage base excludes fringe benefits. If fringe benefits are treated as direct costs, they may be included in the direct salary and wage base.
- I. The rate of 48.71% developed in the sample format is applicable to all direct salaries and wages of the institution. Generally, off-campus rates are not negotiated with institutions that use the simplified method. Therefore, it is essential that consistency of treatment be afforded to all indirect cost elements, (e.g., rental of separate facilities should be treated as an indirect (O&M) cost rather than as a direct cost on sponsored agreements). To the extent that sponsored agreements have been funded in a manner that reflects a need for an off-campus rate, the rate should be developed in a manner similar to the development of a “regular” rate, except that it should exclude use allowances/depreciation, O&M expenses and libraries expenses.

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COMPUTATION OF OFF-CAMPUS RATE

Indirect Costs Per Schedule 2				\$ 5,889,000
	S&W	Other	Total	
Less:				
Use Allowances	\$ -0-	\$ 277,000	\$ 277,000	
O&M Expenses	\$ 600,000	\$ 1,490,000	\$ 2,090,000	
Library Expenses	\$ 520,000	\$ 138,000	\$ 658,000	
Subtotal	\$ 1,120,000	\$ 1,905,000	\$ 3,025,000	(\$ 3,025,000)
Indirect Cost Applicable to Off-Campus Projects				\$ 2,864,000 (a)
Direct Salaries and Wages				\$ 12,089,000 (b)
Off-Campus Rate (a) / (b)				23.7%