



**Early Childhood Iowa
Indirect Cost Rate Principles
Tool H (A)**

What are Indirect Costs?

Indirect costs are those that have been incurred for common objectives benefiting all programs and cannot be readily identified or assignable to a particular final cost in a program (OMB circular A-122). Indirect costs relate to central management and administrative functions that are necessary and beneficial to all programs administered by the organization.

What is the Purpose of the Indirect Cost Rate (ICR)?

An indirect cost rate provides a systematic and accurate method for charges that result in an equitable distribution of indirect costs. Without an approved indirect cost rate, agencies (service providers) directly charge grants and contracts for costs such as executive director, accounting staff, space, etc. The problem with direct charging is that the costs are based on budget estimates or arbitrary allocations based on the availability of funds. Establishing an indirect cost rate is in compliance with federal cost principles and is a strongly encouraged practice for agencies that administer a variety of Federal, State and local programs. An ICR is typically utilized by agencies managing multiple contracts, as well as local, state and federal government.

Who Negotiates and Approves Indirect Cost Rates?

An agency's indirect rate is established and approved by the federal agency from which they receive the greatest portion of their funding. If the greatest source of funding is from a state agency, then the state agency approves the indirect cost rate. After a rate is established it will be accepted by all federal and state agencies. An indirect cost proposal's compliance is verified by the agency's annual audit. Once a rate is established an agency must apply the indirect cost rate to all programs and contracts.

What Does the Rate Accomplish?

- An indirect cost rate provides a better system for cost accounting and minimizes future audit risks.
- An indirect cost rate ensures that the agency will meet OMB circular A-133 requirements.
- An indirect cost rate eases accounting burdens through cost pooling and eliminates arbitrary direct charging of management and administrative costs.
- An indirect cost rate encourages all funding sources to pay their fair share as determined by the established cost rate.
- An indirect cost rate develops actual costs, which are essential for assessing results and performance.

How does Indirect Cost Rates Impact ECI Area Boards?

Contracting with an agency (service provider) that has a federally-approved indirect cost rate:

The ECI Area board will want to determine a policy or procedure for reimbursement for administrative-related expenses when contracting with an entity that does have an approved indirect cost rate. The ECI Area board needs to determine if they will support that rate or if they want to negotiate any specifics for the rate with the service provider.

When a contractor has an approved indirect cost rate, the proof of that rate determination should be provided to the ECI Area Board as the local funder. The information provides dependable documentation regarding the rate necessary for the operation of that entity.

Contracting with an agency that does not have an approved indirect cost rate:

The ECI Area board will want to determine a policy or procedure for coming to agreement regarding reimbursement for administrative-related expenses when contracting with an agency that does not have an approved indirect cost rate. This will assist both the area board and the service providers.

As policies are developed, this information should be made available to contractors. This can be accomplished by having the information included on the local website. As RFPs are released, the indirect policies could be added into the document or provided as an addendum.

Reference Materials:

Cost Principles and Procedures for Developing Cost Allocation Plans and Indirect Cost Rates for Agreements with the Federal Government. A guide that includes helpful information for indirect cost rate determination.

<http://rates.psc.gov/fms/dca/asmb%20c-10.pdf>

OMB circular A-87 http://www.whitehouse.gov/omb/circulars_a087_2004

OMB circular A-122 http://www.whitehouse.gov/omb/circulars_a122_2004#ac

OMB circular A-133 http://www.whitehouse.gov/omb/circulars_index-slg