

APPENDIX 9

INDIRECT COST

The purpose of Indirect Cost is to capture overhead costs incurred by a CBO that operates several programs and whose administrative costs cannot be specifically identified as a direct cost to the program. CBOs with multiple programs where some administrative costs are shared may incur indirect costs. Any of the generally accepted methods of calculating and allocating indirect cost may be used.

One common method of developing an indirect cost rate is described in the federal Office of Management and Budget Circular A-122, Cost Principles for Nonprofit Organizations. The following discussion of Indirect Cost Rate calculations is excerpted from and reprinted with the permission of the Department of Health and Human Services, Administration for Children & Families, Compassion Capital Fund based on the principles of Circular A-122.

The maximum Indirect Cost Rate allowed by DYCD is 10%.

CALCULATING INDIRECT COST RATES

In a multi-program organization, all costs can be divided into two different types: direct and indirect. Direct costs are those that are clearly and easily attributable to a specific program.

Indirect costs are those that are not easily identifiable with a specific program, but which are, nonetheless, necessary to the operation of the program. These costs are shared among programs and, in some cases, among functions (program, management and general administration).

There are several methods for allocating Indirect Costs. The two most common are case-by-case allocation and developing an indirect cost rate.

Case-by-Case Allocation: One method of allocating indirect costs is to determine a rate of actual usage for each program. For example, you may decide to keep track of long distance telephone calls and charge them to the appropriate program when you pay the phone bill each month. Similarly, some organizations use a counter or log to track copying expenses for each program and/or function. Time sheets may form the basis for allocation of salaries for the program director, accountant, and staff whose work benefits more than one program or activity. A different method can be adopted for each line item or case.

For those shared expenses which cannot easily be divided directly into programs and functions, an indirect cost rate is useful.

Developing an Indirect Cost Rate: The first step in determining an indirect cost rate is to separate all costs into two groups: **direct and indirect costs**. The indirect costs are aggregated into an indirect cost "pool" and then allocated to the programs based on a set proportion or rate.

There are several measures used to determine the proportion of indirect costs to allocate (apply) to each program. The following simple example illustrates an indirect cost rate based on the relationship between total indirect costs and total direct costs:

EXAMPLE:

1—The A&B CBO

The A&B CBO has a total budget of \$3,300. The budget is distributed as follows:

Program A has direct costs of \$1,000

Program B has direct costs of \$2,000

Indirect costs to run the programs is budgeted at \$300

Total costs are \$3,300

Since Program A's direct costs are one-third of the total direct costs of the agency (\$1,000 out of \$3,000), it should bear one-third of the indirect costs. Similarly, since Program B incurs two-thirds of the total direct costs of the agency, it should bear two-thirds of the indirect costs, as well.

The A&B CBO can create an indirect cost rate which will allow it to easily accomplish this allocation. An indirect cost rate (using direct costs as a base) is established by dividing the total indirect costs by the total direct costs. For the A-B CBO the indirect cost rate is:

Total Indirect Costs divided by Total Direct Costs = $\$300/\$3,000 = 10$ percent of total costs.

Each program's share of indirect costs can be calculated as a proportion of its direct costs:

Program A Indirect Expenses: $\$1,000 \times 10\% = \100

Program B Indirect Expenses: $\$2,000 \times 10\% = \200

Total Indirect Expenses = \$300

After the indirect costs have been allocated to the programs, the budget now reads as follows:

Program A has direct costs of \$1,000, indirect costs of \$100 = \$1,100

Program B has direct costs of \$2,000, indirect costs of \$200 = \$2,200

Total costs are \$3,300

This illustrates that after Program A has picked up its fair share of indirect costs, the true cost of running Program A is \$1,100. As you can see from this example, using direct costs as a basis for your indirect cost rate will result in larger programs being charged with more of the indirect costs than smaller programs.

There is more than one way to calculate an indirect cost rate and any of the generally accepted methods of calculating and allocating indirect cost may be used. Organizations may allocate indirect costs based on how many people are served in each of their programs, how large each of their sites is, or other logical methods. Whatever cost allocation method is chosen must be applied consistently. It is the responsibility of the CBO to maintain documentation to justify the allocation plan used to arrive at the indirect cost rate. This documentation must be made available upon DYCD's request.

Any questions regarding Indirect Cost may be directed to the Contract Agency Audit Unit of DYCD.