

Indirect Costs and the \$25,000 Rule

All Michigan public school districts and charter schools have federally approved indirect cost rates calculated and published by the Michigan Department of Education on an annual basis. These rates can be used to reimburse the general fund for administrative and other costs that are not easily allocated to a particular program at the district.

The federal government has determined that costs related to some contracted services are distorting in nature, and must be excluded in part from the calculation of indirect cost rates. The underlying rationale is that if a district chooses to contract with outside vendors to provide services within the district, those contracts have a tendency to reduce the administrative effort required by the district to complete that function. As an example, if a district chooses to contract with an outside vendor to provide transportation services, the district no longer handles payroll for bus drivers or the payment of invoices to a fuel supplier. Therefore, it could be considered distorting for the entire cost of providing transportation to be included in the calculation of an indirect cost rate for the district.

In very general terms, the rate is calculated by dividing indirect costs by the direct cost base. In order to address these distorting costs, the district is to request an exclusion for the amount of any contracted service in excess of \$25,000 that impacts the direct cost base. This rule is not intended to reduce rates, therefore it does not apply to functions that are included in the numerator, or indirect side of the equation.

To be consistent, indirect rates should only be applied by the district to the first \$25,000 of any contract or subgrant related to a federal grant. This general principle applies to all costs that are excluded from the indirect cost rate calculation. If the cost is excluded from the rate calculation, the district should not apply an indirect rate to that cost.

Please be aware that a similar principle applies to flow-through grants. Any funds flowing through a district to another educational entity should be excluded from the rate calculation. Indirect rates should not be applied to any of these excluded costs.