

Funders for Real Cost, Real Change

INDIRECT COST RATE GUIDE

2022

Developed for Funders for Real Cost, Real Change (FRC) by BDO FMA and BDO Nonprofit Advisory, practices of BDO USA.

FRC was a collaborative of 12 member funders that explored ways to improve indirect cost recovery in project grants from 2019 - 2021. Members included Arnold Ventures, Conrad N. Hilton Foundation, David and Lucile Packard Foundation, Ford Foundation, James Irvine Foundation, John D. and Catherine T. MacArthur Foundation, Oak Foundation, Open Society Foundations, Robert Wood Johnson Foundation, Rockefeller Foundation, W.K. Kellogg Foundation, and William and Flora Hewlett Foundation. FRC was facilitated by BDO FMA.

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I. Introduction

OVERVIEW AND PURPOSE

This guide provides a framework for determining and calculating an overall indirect cost (IDC) rate for a US-based nonprofit organization. This rate would then be applied to grants from participating funders, rather than calculating indirect costs on a funder-by-funder or grant-by-grant basis.

“FAIR SHARE” COST COVERAGE

The funders who commissioned the development of these guidelines are seeking to better understand and cover the indirect costs associated with projects for which they make grants. As such, there are no *a priori* maximum indirect cost rates or limitations associated with these guidelines, although individual funders may have their own approaches or policies associated with indirect cost coverage (e.g., allowable versus unallowable costs or costs to be included versus excluded). Organizations using these guidelines should strive to present a true and unapologetic picture of the direct and indirect costs associated with running their operations.

ASSUMPTION OF REASONABLENESS

These guidelines assume that the costs that an organization includes in calculating its indirect cost rate are reasonable and necessary to carry out its organizational activities. As such, the guidelines do not specify caps or exclusions of particular types of costs. Individual funders may exclude or limit certain types of costs from grant budgets based on their own policies.

CONSISTENCY BETWEEN IDC RATE CALCULATION AND COST CLASSIFICATIONS IN GRANT BUDGETS

This document provides *guidance* in determining an indirect cost rate rather than a strictly prescriptive policy/methodology of indirect cost rate calculation. Cost classification depends on an organization’s own unique circumstances and business model, and it is possible that similar types of costs may be classified differently in different organizations. (As such, please note that indirect cost rate percentages may not be strictly comparable across organizations.) It is important however for both organizations and funders to understand that, in order for this guide to serve its purpose, the basis on which each grant is budgeted **must be consistent** with the basis on which an organization’s indirect cost rate has been calculated. The same cost must not be treated as indirect for purposes of calculating an indirect cost rate and then budgeted as a direct cost within a grant (or vice versa). Such inconsistency could result in double-charging of costs to funders and/or indirect cost rates on grants that are inadequate to the goal of full cost recovery and “fair share” cost coverage.

Thus, it is critical for both organizations **and their funders** to understand not only the indirect cost rate (percentage) of organizations using this guidance but also the way in which costs have been **classified** to determine that rate. The indirect cost rate “number” alone is inadequate without this context.

II. Methodology for Establishing an Organization’s Indirect Cost (IDC) Rate

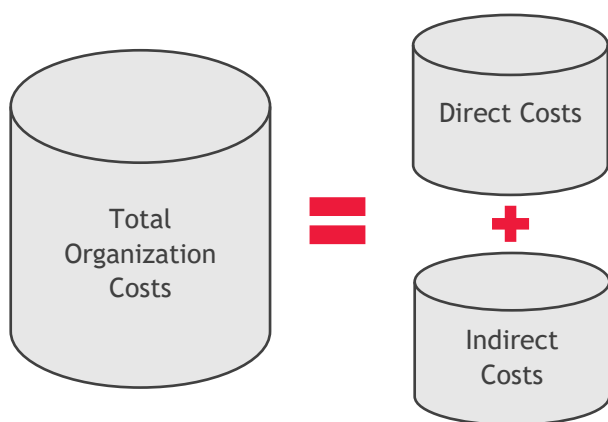
BASIS OF CALCULATION

The IDC rate should be calculated based on a **full year** of expense data. Ideally, this would represent actual expenses from an organization’s most recently completed fiscal year. If such data is not available (e.g., for a new organization), the rate may be calculated based on best available data, such as the organization’s current year budgeted or projected expenses.

IDC rates calculated on the basis of these guidelines should be considered applicable for at least one year. In the case of multi-year grants or grants that cross multiple fiscal years, individual funders may choose to recognize the IDC rate of the year in which the grant is made for the life of the grant term or may request organizations to submit updated rates each year.

TOTAL COST

The total costs of an organization comprise direct costs and indirect costs. The following definitions may be used to categorize costs as direct or indirect.



DEFINITION

Costs that can be specifically associated with the organization’s programmatic activities or allocated to such activities relatively easily and with a high degree of accuracy.

Costs incurred for a common or joint purpose benefitting more than one program and not readily assignable to the program(s) without effort (disproportionate to the results achieved).

DIRECT COSTS

Direct costs are all costs specifically associated with the delivery of programmatic services in furtherance of an organization’s purpose and mission.

Examples of direct costs include salaries and other personnel costs associated with delivery of programmatic services, supplies and materials used for program delivery, program-related travel costs, training costs that relate specific to program implementation, etc.

INDIRECT COSTS

Indirect costs are costs associated with running and managing the general administrative functions of the organization that support the ultimate delivery of programmatic services. These are costs not directly associated with the delivery of programs; they are however essential costs of maintaining and managing the nonprofit organization through which program services are delivered.

Examples of indirect costs include areas such as an organization's finance function, audit costs, human resource administration, planning, board meetings, legal and regulatory compliance, grants and contracts management for the organization, CEO role, etc. For purposes of this guide, costs associated with fundraising are also considered indirect costs.¹

ALLOCATING SHARED COSTS

Certain resources by their nature are often shared among the multiple functions of an organization. Common examples of this type of resource are facilities, utilities, and telephone/internet service. While the costs of these resources are not readily identifiable to a single program or function, they are necessary costs to the operation of the organization (including its programs).

Shared costs should be allocated across relevant activities based on a reasonable estimate of the utilization of the resources by each activity. Allocation bases for shared costs should be:

- Reasonable
- Consistently applied
- Supported by accurate and current data
- Appropriate to the particular cost being distributed
- An accurate measure of the benefits provided to each activity of the organization

Costs that cannot be allocated to activities in a way consistent with these criteria should generally be categorized as (entirely) indirect costs.

Shared costs should use an appropriate allocation basis for apportioning the costs between activities. These may include:

1. Staff level of effort (measured by staff FTEs or full-time equivalents) allocation methodology for costs that are generally driven by staff utilization, such as telephone/internet expenses, office supplies, etc.
2. Space/square-footage allocation methodology for occupancy-related costs (e.g., rent), where physical space is specific to particular programs or activities.
3. Other bases for allocation may be appropriate in particular circumstances if another basis would better approximate actual use of the resource.

¹ Note that this section does not specifically distinguish between fundraising associated with securing restricted funds (e.g., grant writing) and fundraising for general support (e.g., annual campaigns, special events, direct marketing). Organizations that conduct significant unrestricted fundraising activities may wish to treat the costs of those activities as **direct** rather than indirect, to avoid the effect of those costs on the indirect cost rate. Some funders may require this adjustment (see Assumption of Reasonableness section above).

The portion of such shared costs **allocated to an organization's programmatic activities** should be considered Direct Costs for purposes of calculating an indirect cost rate. The portion of these costs **allocated to an organization's supporting services** (management, administration, fundraising, etc.) should be considered Indirect Costs for purposes of calculating an indirect cost rate.

For **personnel** who spend time in both direct and indirect activities, the percentage of time spent in each type of activity should be based on a reasonable estimate (for example a timesheet) and personnel costs assigned proportionately based on the time spent on each type of activity.

For more information, see **Attachment 2: Examples of Shared Cost Allocation** below.

INDIRECT COST RATE FORMULA

An organization's indirect cost rate is a percentage calculated as the ratio of indirect costs to direct costs.

$$\text{IDC Rate (\%)} = \frac{\text{Total Indirect Cost}}{\text{Total Direct Cost}}$$

III. Other Guidelines

ADJUSTMENTS TO COST BASIS

Organizations calculating an indirect cost rate on the basis of a previous year's data may have experienced changes to their cost structure or business model that would make a rate calculated on that basis inaccurate for current and future grants. For example, an organization may add a new senior administrative staff position that increases its total indirect costs, or may increase programmatic scale or scope in a way that significantly increases its direct costs.

In such cases, organizations may make appropriate adjustments to their direct cost or indirect cost totals and calculate an indirect cost rate on the basis of those adjustments. These adjustments should be specified and documented.

INDIRECT COST BASE: TOTAL COST VS. OTHER COST BASES

By default, these guidelines assume that organizations will calculate and present their IDC rate on the basis of the ratio between total indirect and total direct costs ("Total Cost" basis). However, in certain circumstances organizations may find that the Total Cost basis presents a distorted or inaccurate representation of their true level of indirect costs. For example, if an organization engages in a significant level of grantmaking to sub-grantees (constituting direct costs), it may find that its indirect cost rate as calculated on a Total Cost basis is lower than necessary to achieve adequate indirect cost recovery. (Organizations may also use a basis other than Total Cost in order to maintain consistency with indirect cost rate calculations developed for other funders.)

In such circumstances, an organization may wish to present an indirect cost rate calculated on a basis other than Total Cost. Examples may be Labor cost (i.e., ratio of indirect labor costs to direct labor costs) or Modified Total Direct Cost (MTDC) (i.e., ratio of indirect costs to direct cost less the cost of "distorting items"). MTDC may exclude costs such as equipment purchases, charges for patient care, rental costs, tuition remission, scholarships and fellowships, participant support costs and the portion of each subaward in excess of \$25,000.

If choosing a calculation basis other than Total Cost, the organization should be clear and transparent about the alternative basis chosen. Additionally, the basis for indirect cost recovery in grant budgets should be consistent with the basis chosen for calculating the organization's indirect cost rate. For example, if an organization calculates its indirect cost rate on an MTDC basis that excludes subawards in excess of \$25,000, only the first \$25,000 of each subaward would be eligible for indirect cost recovery in grants. (See "Consistency Between IDC Rate Calculation and Cost Classifications in Grant Budgets" in Section I above.)







DOCUMENTATION

Organizations calculating an indirect cost rate based on these guidelines should provide documentation of the data, methods and assumptions on which this calculation is based. (For an example of an organization cost policy statement, see www.dol.gov/sites/dolgov/files/OASAM/legacy/files/DCD-2-CFR-Guide.pdf#page=32.)

Appendix 1: Categorization of Typical Costs

The table below notes categorizations of some of the most common areas of costs for nonprofit organizations. Please note that this list is representative but not comprehensive or exhaustive, and exceptions will apply in particular circumstances.

Example of Cost	Generally Considered Direct Cost	Generally Considered Indirect Cost	May be a Shared Cost to be Proportionally Allocated	Notes
Personnel costs (salary, benefits, taxes, bonus) of staff working directly on programmatic activities	✓			For staff members who work in both programmatic and non-programmatic areas, the programmatic portion of their time (and corresponding personnel costs) would be categorized as direct and the non-programmatic as indirect (See Appendix 2)
Personnel costs (salary, benefits, taxes, bonus) of: <ul style="list-style-type: none"> • Management and administrative staff (e.g., ED/CEO; CFO; accounting, human resources, legal, IT staff) • Fundraising staff (Development Director, grant writer) 		✓		
Professional fees of consultants working on programmatic activities	✓			
Professional fees of management consultants (legal, accounting/audit, human resources, IT, fundraising, etc.)		✓		

Example of Cost	Generally Considered Direct Cost	Generally Considered Indirect Cost	May be a Shared Cost to be Proportionally Allocated	Notes
Sub-grants and awards				Organizations with significant subgranting activity may choose to exclude some or all subgrant expenses in calculating their indirect cost rate (see “Total Cost vs. Other Cost Bases” in Section III above)
Rent, occupancy, and maintenance costs				Costs of facilities exclusively used by programmatic or non-programmatic activities may be classified as direct or indirect, respectively
Utilities, telephone, internet				Costs of utilities exclusively used by programmatic or non-programmatic activities may be classified as direct or indirect, respectively
Project supplies and materials				
General insurance, bank fees, credit card fees, interest				Insurance and fees associated entirely with programmatic activities may be classified as direct costs
Staff training and professional development costs				Staff training and professional development related to programmatic activities may be classified as direct costs, while training and professional development related to non-programmatic activities may be classified as indirect costs

Example of Cost	Generally Considered Direct Cost	Generally Considered Indirect Cost	May be a Shared Cost to be Proportionally Allocated	Notes
Advertising and marketing		✓		Advertising and marketing costs that promote the goals and objectives of a program may be considered direct costs
Travel, meetings and conferences related to programmatic activities	✓			
Travel costs related to non-programmatic activities (e.g., donor events, board meetings)		✓		
Equipment (or depreciation on capital equipment) purchased for programmatic purposes	✓			Costs of equipment exclusively used for non-programmatic activities may be classified as indirect costs
Depreciation of general facilities and capital equipment		✓		Depreciation expense may be totaled and categorized as an indirect cost

Note: transfers of funds to endowments or operating reserves are not considered “costs” and should not be included in cost calculations for purposes of developing an indirect cost rate.

Appendix 2: Examples of Personnel Cost and Shared Cost Allocation

PERSONNEL COSTS

Staff members who work **exclusively** in an organization's programmatic functions should have their personnel costs classified as direct costs.

Staff members who work exclusively in an organization's non-programmatic (administrative/management/fundraising) functions should have their personnel costs classified as indirect costs.

For staff members who work in **both** programmatic and non-programmatic areas, the programmatic portion of their time (and corresponding personnel costs) should be categorized as direct and the non-programmatic portion as indirect.

For example, an organization's Director of Operations with total personnel costs (salary/wages, taxes, benefits) of \$100,000 spends 2 days per week doing programmatic work and 3 days per week doing non-programmatic work (administration, management, fundraising). Their personnel costs may be allocated as follows:

- Direct costs (programmatic): $40\% * \$100,000 = \$40,000$
- Indirect costs (non-programmatic): $60\% * \$100,000 = \$60,000$

NON-PERSONNEL COSTS

In some cases, shared **non-personnel** costs could use an appropriate allocation basis for apportioning the costs between direct and indirect categories. The allocation basis chosen should be a reasonable approximation of the benefits derived by each category of the resource being allocated. (Shared costs that cannot be readily allocated among activities on a reasonable and accurate basis should be categorized as indirect costs.)

Example A: rent in a shared facility allocated on a **square footage utilization** basis

- Rent expense: \$100,000; Facility square footage: 1,000 ft²
- Facility utilization by programmatic activities: 800 ft²; Facility utilization by non-programmatic activities: 200 ft²
- Direct costs: $80\% * \$100,000 = \$80,000$
- Indirect costs: $20\% * \$100,000 = \$20,000$

Example B: rent in a shared facility allocated on a **staff level of effort or full time equivalent (FTE)** basis

- Rent expense: \$100,000; total staff full-time equivalents: 10
- Staff full-time equivalents in programmatic functions: 7; Staff full-time equivalents in non-programmatic functions: 3
- Direct costs: $70\% * \$100,000 = \$70,000$
- Indirect costs: $30\% * \$100,000 = \$30,000$

These materials are meant to provide general information and should not be used or relied upon to cover specific situations and you should not act, or refrain from acting, upon these materials without obtaining specific professional advice tailored to your individual needs. Please confer with legal counsel and/or other applicable professionals that you deem appropriate before taking or refraining from taking any action based upon or related to any of these materials. Each of BDO USA, LLP and its affiliates does not accept or assume any responsibility or liability in respect of any use of or reliance on or related to these materials. Any use of or related to these materials or reliance thereto is at your own risk, without any right of recourse against BDO USA, LLP or its affiliates.