



Memorandum

Subject: Clarification of Policy on Indirect Costs of
State and Local Governments

Date: May 5, 2004

From: Sandra L. Weisman
Director, Office of Budget and Finance

In Reply Refer To:
HABF-40

To: Division Administrators
Directors of Field Services
Resources Center Managers

Section 1212(a) of the Transportation Equity Act for the 21st Century (TEA-21), amended section 302 of title 23, United States Code (U.S.C.), to allow the State transportation departments (STD) to claim reimbursement of indirect costs. The Federal Highway Administration (FHWA) later rescinded title 23, Code of Federal Regulations (CFR), part 140, subpart G, which also precluded local governments from claiming reimbursement of indirect costs. As a result of these legislative and regulatory changes, State and local government agencies can be reimbursed for indirect costs subject to the provisions of the Office of Management and Budget Circular A-87 (OMB Circular), "Cost Principles for State, Local, and Indian Tribal Governments." Since grantees are not required to claim indirect costs, these procedures only apply to agencies seeking reimbursement of these costs.

The following regulations and guidance govern the reimbursement of indirect costs:

- Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments, 49 CFR, part 18 (U.S. Department of Transportation implementation of the common rule)
http://www.access.gpo.gov/nara/cfr/waisidx_02/49cfr18_02.html
- Cost Principles for State, Local, and Indian Tribal Governments, OMB Circular A-87
<http://www.whitehouse.gov/omb/circulars/a087/toc.html>
- Implementation Guide for OMB Circular A-87 (ASMB C-10), Department of Health and Human Services (HHS) <http://www.hhs.gov/grantsnet/state/index.htm>
- FHWA September 24, 1998, Memorandum: Indirect Costs Eligibility and Other TEA-21 Revisions to Title 23 U.S.C. Section 302 <http://www.fhwa.dot.gov/tea21/indcosts.htm>



Any memorandums or directives issued by the FHWA prior to the enactment of TEA-21 relating to the eligibility of administrative, overhead, or indirect costs are rescinded. While the policies regarding the development and approval of indirect cost rates are contained in the Circular, several questions have been raised about the application of these policies to the FHWA programs. The purpose of this memorandum is to clarify several key points relating to the FHWA's approval of indirect cost rates.

Federal-aid highway program funds may participate in the indirect costs of State and local governments when the costs are properly allocated to all benefiting cost objectives in accordance with the provisions of the Circular.

The Circular provides some flexibility in the methods that may be used to distribute indirect costs in specific situations. However, for most indirect costs, the State or local government must prepare an indirect cost rate. The FHWA is the cognizant Federal agency for the STD, and the Division Administrator is authorized to approve indirect cost rates. The STD is responsible for assuring the local governments indirect costs comply with the requirements of the Circular when Federal-aid funds are passed through the STD.

The Circular requires that indirect costs be allocated to benefiting cost objectives (non-Federal and Federal) and that the costs be distributed to individual Federal awards. In the FHWA terminology, this means that indirect costs must be distributed to individual Federal-aid projects or activities receiving a specific obligation of Federal funds.

In accordance with the Circular, Attachment E, the STD must develop and submit its indirect cost rate proposal to the FHWA for approval. The approved indirect cost rate would then be applied to a direct cost base incurred by the STD on the project. Total direct salaries and wages or total direct costs are generally used as direct cost bases, but the Circular offers some flexibility in defining the base. In accordance with the Circular, the total direct cost base generally excludes funds "passed through" to a subgrantee, capital expenditures, major subcontracts, etc. when these costs would distort the equitable allocation of indirect costs.

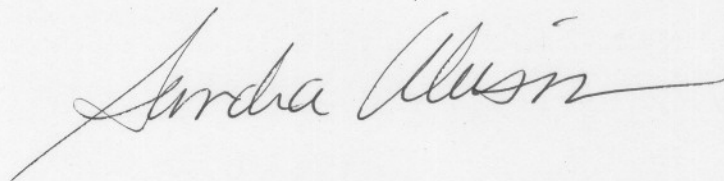
A separate Federal-aid project cannot be established for the sole purpose of claiming indirect costs.

In accordance with the general principles of Federal appropriation law, Federal funds can only be obligated for the purpose authorized by Congress. Each Federal-aid project authorized by the FHWA must be for an eligible activity consistent with the purpose of the program, such as highway construction, planning, one of the twelve specific transportation enhancement activities, etc. Since indirect costs are not specified as a purpose of any Federal-aid program, it is not appropriate for the FHWA to authorize a specific project for indirect costs. Furthermore, when indirect costs are claimed, the Circular requires that the costs be distributed to each Federal award (i.e., project) that benefits from the indirect costs.

A separate Federal-aid project may only be established for the purpose of administering a program when authorized by statute.

Administrative costs and indirect costs are not necessarily the same thing, but these terms have been used interchangeably perhaps resulting in some confusion. Administrative costs are those costs associated with the management of a program, while indirect costs are simply those that benefit more than one activity. Since administrative costs generally benefit more than one activity, they are normally classified as indirect costs. However, Congress may authorize grant funds specifically for the purpose of administration. This is the case for the Recreational Trails Program, where the costs of program administration are specifically authorized as an eligible activity under 23 U.S.C. 206(d)(2)(F). This administration project may consist of both direct and indirect costs. An administration project cannot be approved for other Federal-aid programs, such as the Transportation Enhancement Program, Surface Transportation Program, Congestion Mitigation and Air Quality, etc. Similarly, the State Planning and Research and Metropolitan Planning funds may not be used to administer these programs.

If you have any comments or questions relating to indirect costs, please contact Dale Gray at (202) 366-0978.

A handwritten signature in cursive script, reading "Sandra Alusin". The signature is written in dark ink and is positioned in the lower right quadrant of the page.