All across the Nation, budgets for public works projects are being seriously cut. If your agency is like most, you’re looking for ways to cover your cost of operations — and not only with direct costs, but also with the indirect ones that support the computer you're using and the office you’re occupying.

An increasingly popular method for covering indirect costs is to include them as a reimbursable item on federally funded projects. While this approach won’t increase the value of your award, it will provide an additional method for funding indirect costs.

If this is something your agency wants to do, you must first develop an Indirect Cost Allocation Plan, or ICAP. An ICAP spells out your objectives and all the methods your agency will need to use in order to calculate its indirect cost allocation and achieve an equitable allocation of indirect costs to all projects. There are some guidelines you’ll be expected to follow, but the methods you ultimately use will be based on your organization's objectives.

**Set Objectives**

Here we will look at some different ways of calculating indirect rates and the steps agencies will take to finalize their ICAP.

Your agency’s indirect rate is the centerpiece of the ICAP and is calculated by dividing indirect costs by direct costs. While the calculation is fairly straightforward, consideration must be given to what to include in the indirect cost pool (the equation’s numerator) and in the allocation base (the denominator).

\[
\frac{\text{Indirect Cost}}{\text{Direct Cost}} = \text{Indirect Rate}
\]

For example, it’s up to your agency to decide whether the indirect cost pool will include “central services” — those departments that process payroll and provide legal advice. It’s also up to your agency to determine whether the direct allocation base will be limited to direct salaries and wages, like project inspectors or project managers, or if it will also include other direct project costs like contractor payments.

While the single indirect rate is the most commonly used approach, some agencies do choose to develop multiple rates. For example, an agency might want one rate for public works projects and another rate for transit. Or an agency might designate a special rate for use only during emergency relief efforts.
Determine Approach

Smaller agencies tend to use actual costs to compute a provisional rate. This is because provisional rates are easier to justify than estimated or predetermined ones and, consequently, tend to be a bit higher. Larger agencies, however, seem to prefer predetermined rates because they tend to project 3-4 years out rather than relying on annual evaluation and adjustment – making them easier to administer.

As long as the indirect costs are allowable under current Federal-aid regulations, what you include in the cost pool and the allocation base, the number of rates you develop, and the accounting method you use is at your agency’s discretion.

Determine Accounting Method

Once your agency has worked through the details, you need to document the proposal and submit the plan to the Federal or State agency providing the Federal funding. One of those two agencies will conduct an audit and review. That agency’s approval is your green light to begin requesting reimbursement of indirect costs on projects.

Document Proposal, Submit Plan and Apply Rate

If your agency is new to the development of ICAPs, you’ll be interested in the many different resources available to guide you through the process. Your primary resource, of course, is the Federal or State government agency providing the funding. The people there can help you define your goals and objectives and then select the most appropriate approach for your situation. They may even be able to show you a plan submitted by another agency – one that shares your objectives or has a similar organizational structure.

Collect Resources

We have just reviewed all the steps agencies will take to finalize their ICAP.

- Start by collecting your resources
- Then set objectives
- Determine your approach and accounting method
- Document and submit your proposal for approval before applying the indirect rate
The content of this document is not a substitute for information obtained from State departments of transportation, appropriate FHWA Division Offices, and applicable laws. Scenarios have been simplified for emphasis and do not necessarily reflect the actual range of requirements applicable to the scenario or this topic. This document was created under contract number DTFH61-11-D-00025 by the Federal Highway Administration, U.S. Department of Transportation, and is offered to the public to heighten and focus awareness of Federal-aid requirements within the local public agencies community and reinforces the importance of these necessary policies, procedures, and practices.

This companion resource is the script content for the video production of the same name.