

Cost Policy Statement - Indirect Cost Rate Agreement Number 2009-023

This Cost Policy Statement is in regard to the New Jersey Department of Education (NJ-DOE) Local Education Agency (LEA) Indirect Cost Plan:

1. **Status of LEA Plan** - We are hoping to conclude negotiations by May 2009. We have enclosed draft agreement 2009-023 effective July 1, 2009 through June 30, 2014. (NOTE: PLAN HAS SUBSEQUENTLY BEEN APPROVED)
2. **Site Visits** – The US-ED most recent site visit was conducted during the summer/fall of 2006 for the purpose of reviewing approved LEA application files. Prior to that visit, on July 22, 1994 John Masaitis of the US-DOE reviewed the Local Education Agency (LEA) methodology.
3. **Rate Methodology** – Currently, the State of New Jersey approves restricted and unrestricted LEA indirect cost rates based upon LEA applications prepared by the LEA on forms produced by the State Education Department using the **Fixed Rate with Carry Forward Methodology** and data from the independently audited Comprehensive Annual Financial Report (CAFR). Also included in our plan is guidance on how to handle the carry forward when the LEA skips one or more annual filing period.
4. **Rate Approval** - Requesting approval of a LEA indirect cost rate is voluntary on the part of LEAs. An average of 17 New Jersey LEAs applied for, and received approval of an indirect cost rate for their Federal grants and sub-grants in the last three years.
5. **School Statistics** - The NJ-DOE reviews indirect cost rate applications and approves the indirect cost rates for those LEA's that apply for them. In New Jersey there are 594 operating school districts and 23 "non-operating" school districts. Non-operating school districts have a board of education but send their students to another district.
6. **Terminal Leave** - The Cost Principles for State, Local and Indian Tribal Governments at 2 CFR, Part 225, (OMB Circular A-87) establish standards for determining costs on Federal awards carried out through grants, cost reimbursement contracts, and other agreements. Attachment B of the Circular addresses selected items of cost and Paragraph 8.g. provides the criteria for Severance pay as follows:
 - 1) Payments in addition to regular salaries and wages made to workers whose employment is being terminated are allowable to the extent that, in each case, they are required by (a) law, (b) employer-employee agreement, or (c) established written policy.
 - 2) Severance payments (but not accruals) associated with normal turnover are allowable. Such payments shall be allocated to all activities of the governmental unit as an indirect cost.
 - 3) Abnormal or mass severance pay will be considered on a case by case basis and is allowable only if advance approval is received by the cognizant Federal agency.

Normal Severance Payments:

Severance payments (but not accruals) to separating employees for termination benefits and/or unused leave ("terminal leave costs") associated with normal turnover are treated as indirect costs when computing the restricted and unrestricted indirect cost rate with one exception. When computing the restricted indirect cost rate, terminal leave costs to

employees that are indirect for the Unrestricted Rate, but direct for the Restricted Rate (i.e. superintendent and their office), are considered direct cost payments for rate calculation purposes only. Payments to separating employees for unused leave are not charged as direct costs to any federal awards.

Mass or Abnormal Severance Costs:

The NJ DOE will not issue advance approvals to charge mass or abnormal severance costs to federal programs as an indirect cost. All costs associated with mass or abnormal severance will be treated as disallowed costs for purposes of calculation of the restricted and unrestricted indirect cost rates. Accordingly, early retirement incentive payments (ERIP) are treated as a disallowed cost for purposes of indirect cost rate calculation.

A Guide for State, Local and Indian Tribal Government issued by the US Department of Health and Human Services as the OMB Circular A-87 Implementation Guide (ASMB C-10) and is applicable to grants and contracts awarded by all Federal agencies. In the Guide the section, "Questions and Answers of Attachment B, Item 3-13 provides the following definition of "severance pay":

(1) Mass severance or termination benefits would include all expenses associated with the event. This would include: lump sum payments that may be linked to years of service, increased pension benefits such as granting additional years or eliminating penalties for early retirement, payments of unused leave, and the cost of any other incentive offered to employees as an incentive to leave government service, such as buy-outs.

Under GASB Statement 47 (*Accounting for Termination Benefits*, effective for periods beginning after June 15, 2005) employers must consider the circumstances surrounding the termination of employment and apply judgment to determine whether the benefits offered the employees are an inducement to retire, which is a termination benefit, or alternatively are benefits earned during employment (compensation for employee services). Termination benefits include early-retirement incentives, severance benefits, and other termination-related benefits.

The Chart of Accounts for New Jersey LEAs (2003 and 2008 editions) and Budget Guidelines for New Jersey LEAs require that when an LEA determines that it has made a short-term offer of termination benefits to an employee "normal turnover", and the offer is accepted the current portion of the offer is recorded in the applicable salary/wage general ledger account. However, unused sick leave for retirees or employees that terminate is recorded in Other Employee Benefits, 11-000-XXX-290. Accordingly, the Normal Terminal Leave tab of the electronic Indirect Cost Application for New Jersey districts requires LEA's to isolate "normal" terminal sick pay terminal leave costs and include them as indirect costs for both the Restricted and Unrestricted rate regardless of what function/object codes are used to record the employees' salary, with one exception. For purposes of calculating the restricted rate, normal terminal sick leave costs associated with Superintendent, Chief Executive Officer (CEO), and heads of components (as defined by 34 CFR 76.565(d)(2)) and their immediate offices will be treated as direct costs funded by the district.

7. **Post Retirement Health Benefits** — Generally, Post Retirement Health Benefits ("PRHB") are obligations of the State of New Jersey and paid by the State on a pay as you go basis. District made payments for Post Retirement Health Benefits (PRHB) for additional contributions to the State Health Benefits Program related to personnel

participating in a “mass” early incentive retirement program (ERIP) and are currently recorded in two object codes (objects 232, and 242) within the chart of accounts. The LEA’s have the option of either allocating fringe benefits to each function or reporting them in one function (unallocated). The electronic Indirect Cost Application requires LEA’s to include all PRHB as indirect costs for both the Restricted and Unrestricted rate regardless of where the employees salary is recorded with one exception. For purposes of calculating the restricted rate, PRHB costs associated with Superintendent, Chief Executive Officer (CEO), and heads of components (as defined by 34 CFR 76.565(d)(2)) and their immediate offices will be treated as direct (function code 230).

8. **Subaward Accounting** – The NJ-DOE proposal includes a statement advising LEAs that only the first \$25,000 of a subaward is included in the Base of Application, and only during the first year of the subaward. “Total direct costs less equipment purchases, alterations and renovations, the portion of individual subawards exceeding \$25,000 and flow-through funds.” Note that Amounts exceeding \$25,000 during the first year, as well as the entire subaward amounts during subsequent years, are excluded from the Base of Application/Distribution Base.
9. **Time Distribution in Terms of Sub-recipient Monitoring** – Office of Management and Budget (OMB) Circular A-87, Attachment B, subparagraphs 8(h)(4) and 8(h)(5), requires personnel activity reports if employees work on more than one cost objective. Attachment B, subparagraph 8(h)(3) requires employees working on a single cost objective to support their activities with a semi-annual certification. The current practice of NJ-SEA is for the various program offices to monitor and participate in the resolution of audit findings in this area. Federal Register: July 2, 2004 (Volume 69, Number 127) provides guidance regarding schoolwide programs.
10. **Capital Outlay** - With respect to the Capitalization Policy, anything that is capitalized that meets the criteria below is classified as capital outlay and excluded. Capital Outlay expenditures which are recorded in general fund 12, Object Code 73X, Equipment, include all items that are capitalized, and are treated as excluded costs. The following is NJ-DOE’s capitalization policy:

Equipment items are any instrument, machine, apparatus, or set of articles (including software) which meets all the following criteria:

1. It retains its original shape, appearance, and character with use;
2. It does not lose its identity through fabrication or incorporation into a different or more complex unit or substance;
3. It is nonexpendable; that is, if the item is damaged or some of its parts are lost or worn out, it is more feasible to repair the item than to replace it with an entirely new unit;
4. Under normal conditions of use, including reasonable care and maintenance, it can be expected to serve its principal purpose for at least one year.

The above criteria are adapted from the National Center for Education Statistics (NCES) Financial Accounting for Local and State School Systems, 2003 Edition. One additional point reflected in the NCES supply/equipment decision tree is the capitalization threshold. “If the item exceeds the minimum dollar value mandated by the state or other government unit (with due regard for group control of some items)” and all four of the above criteria have been met, then the item should be classified as

equipment. The capitalization threshold for NJ school districts for budgeting, accounting, and financial reporting purposes is **\$2,000**. This threshold does not preclude a district from using a lower threshold for insurance or asset management/management control purposes. An item should be classified as a supply if it does not meet the stated equipment criteria and the cost is not more than the capitalization threshold of \$2,000.

Governmental Accounting Standards Board (GASB) Statement No. 51, *Accounting and Financial Reporting for Intangible Assets* is effective for periods beginning after June 15, 2009 and provides guidance on recognizing internally generated computer software as an intangible asset. GASBS No. 51 also provides guidance regarding the application of the specified-conditions approach to the development cycle of computer software. NJ districts are required to present financial statements that are in accordance with GAAP.

11. **GASB 34** - Our indirect cost plan does not include any reference to depreciation or use allowances. *Government Accounting Standards Board Statement No. 34, Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments*, (GASB 34) requires LEA’s to report depreciation in the Comprehensive Annual Financial Report (CAFR). While the LEA’s are required to report depreciation in the CAFR, we do not collect this data and therefore do not require the districts to include it in their indirect cost rate calculation.
12. **Public Relations** - Under the New Jersey Chart of Accounts 2008 edition, public relations costs are posted to function-object codes 251-330. The electronic LEA Indirect Cost Application forms are designed to isolate any costs defined by OMB Circular A-87 Attachment B(2)(e) as public relations costs as direct/disallowed costs for restricted (R-1) and unrestricted (U-1) rates .
13. **Board of Education Costs** - Board of Education costs, are recorded in General Administration, (Function 230), and are classified by the electronic LEA Indirect Cost Application forms R-1 (Restricted) and U-1 (Unrestricted) as direct/disallowed costs in both the Restricted (R-1) and Unrestricted (U-1) rate.
14. **Excluded Costs** - Capital outlay, debt service, transfers, internal service fund expenditures, judgments against the school district, and on-behalf pension/social security contributions are excluded costs from the Restricted and Unrestricted methodology.
15. **Food Services** – LEAs record food service in the enterprise fund and therefore these costs are not included in the indirect cost rate calculation. LEA’s have the option of recording a transfer from the general fund to the food service fund to cover any shortfalls. Currently our plan includes this transfer as an allowable cost and is part of the base.
16. **Chart of Account Changes** –The Uniform Minimum Chart of Accounts for New Jersey Public Schools 2008 Edition is effective for the 2009-10 school year; earlier implementation is permissible. The primary change to the COA requires additional detail by program code for the costs associated with instructing at-risk children. NJ-DOE does not anticipate changes that would impact the LEA rate determinations during the term under negotiation. However, the NJ-DOE shall notify US-ED if any unforeseen changes would impact school year rate determinations covered under this agreement. Prior to the

2009-10 school year, Uniform Minimum Chart of Accounts for New Jersey Public Schools 2003 Edition is effective for periods which began on or after July 1, 2004.

17. **Standard Set of Accounting Procedures-** New Jersey Administrative Code 6A:23-2.1 prescribes a standard system of double-entry bookkeeping and GAAP accounting compatible with the financial accounting terminology and classifications established in the federal accounting manual, Financial Accounting for local and State School Systems, 2003 Edition by the National Center for Education Statistics (NCES).
18. **Internal Service Funds-** The electronic LEA Indirect Cost Application is designed so that any payments to internal service funds shall be excluded from the base and pool, and not classified as either direct or indirect costs as they are payments made in anticipation of losses.
19. **Cash Reserves or Fund Balances-** New Jersey accounting practice does not permit the use of federal funds to maintain fund balances. Charges made to increase or maintain cash reserves or fund balances are not expenditures and therefore cannot be charged to federal awards as either direct or indirect costs.
20. **Standard Indirect Request Form, Guidance and Procedures-**LEAs electing to submit a request for an indirect cost rate for a given fiscal year must complete the standard electronic LEA application available on the New Jersey Department of Education website. The application must be presented to the NJ-DOE for approval, and such approval issued prior to the district utilizing the determined restricted and unrestricted indirect cost rates.
21. **Average Rates-**The following are recent average restricted and unrestricted LEA indirect cost rates:

	Restricted	Unrestricted
FY 2004	2.83%	14.87%
FY 2005	4.25%	20.78%
FY 2006	4.07%	21.04%
FY 2007	3.47	18.20%
FY 2008	3.74%	19.30%

22. **Next LEA Rate Review Plan-** The NJ-DOE will submit a new LEA plan by January 1, 2014. This proposal will include a list of negotiated LEA rates for : 2010 through 2014. In addition, it will include filled-in Restricted and Unrestricted indirect cost rate determination matrices, organization charts, and Comprehensive Annual Financial Reports (CAFRs) for the following LEAs:
 - Newark Public Schools in Essex County
 - Jersey City Public Schools in Hudson County
 - Trenton Public Schools in Mercer County
23. **Indirect Cost Rate Plan-** The NJ-DOE will resubmit an updated plan, if necessary, upon request.