

# Direct vs. Indirect Costs And Allowability on Federal Awards

## I. DEFINITIONS

### A. Allowable Costs

From OMB Circular A-21, Section C.2. “The tests of allowability of costs under these principles are: (a) they must be reasonable; (b) they must be allocable to sponsored agreements; (c) they must be given consistent treatment through application of those generally accepted accounting principles appropriate to the circumstances; and (d) they must conform to any limitations or exclusions set forth in these principles or in the sponsored agreement as to types or amounts of cost items.”

### Reasonable Cost Test

A cost is considered reasonable if it is incurred as the result of the actions a “prudent person” would have taken under circumstances prevailing at the time. That is, a reasonable cost is one generally recognized as necessary for the operation of the institution or the performance of the sponsored agreement, and is consistent with established institutional policies and practices applicable to the work of the institution generally, including sponsored agreements.

### Allocable Cost Test

From OMB Circular A-21, Section C.4.a. “A cost is allocable to a sponsored agreement if (1) it is incurred solely to advance the work under the sponsored agreement; (2) it benefits both the sponsored agreement and other work of the institution, in proportions that can be approximated through the use of reasonable methods; or (3) it is necessary to the overall operation of the institution and, in light of the principles provided in this Circular, is deemed to be assigned in part to sponsored projects.”

### B. Unallowable Costs

From CAS 505: “Unallowable cost means any cost which, under the provisions of any pertinent law, regulation, or sponsored agreement, cannot be included in prices, cost reimbursements, or settlements under a Government sponsored agreement ...”

Any cost directly associated with an unallowable cost is unallowable as well. From CAS 505: “Directly associated cost means any cost which is generated solely as a result of the incurrence of another cost, and which would not have been incurred had the other cost not been incurred.”

*Note: A cost may be allowable for the University but unallowable in terms of reimbursement from the Federal government. These costs may be entirely appropriate and permissible in carrying out University activities.*

### C. Direct Costs

From OMB Circular A-21, Section D.1: Direct costs are those costs that can be identified specifically with a particular sponsored project, an instructional activity, or any other institutional activity, or that can be directly assigned to such activities relatively easily with a high degree of accuracy. Costs incurred for the same purpose in like circumstances must be treated consistently as either direct or indirect costs. Where an Institution treats a particular type of cost as a direct cost of sponsored agreements, all costs incurred for the same purpose in like circumstances shall be treated as direct costs of all activities of the institution.

### D. F&A (Indirect Costs)

Facilities and Administrative (F&A) costs are those that are incurred for common or joint objectives and therefore cannot be identified readily and specifically with a particular sponsored project, an instructional activity, or any other institutional activity.

Indirect costs are the facilities infrastructure and administrative costs of the University that are needed to support the programs of the institution, including research and other sponsored programs. Building depreciation, maintenance costs, the cost of utilities, personnel services, accounting and budgeting services, sponsored program services, student services, departmental administration, and human subjects administration are examples of F&A costs.

## **II. OMB Circular A-21**

Cost Principles for Educational Institutions (OMB Circular A-21) - for full text refer to:

[http://www.whitehouse.gov/omb/circulars/a021/a21\\_2004.html](http://www.whitehouse.gov/omb/circulars/a021/a21_2004.html)

OMB Circular A-21 establishes principles for determining costs applicable to Federal grants, contracts, and other sponsored agreements with educational institutions. The last revision is dated May 10, 2004.

Section J of OMB Circular A-21 provides 54 principles to be applied in establishing the allowability of certain items that are involved in determining cost. These principles should apply irrespective of whether a particular item of cost is properly treated as direct cost or F&A cost. Failure to mention a particular item of cost is not intended to imply that it is either allowable or unallowable; rather, determination as to allowability in each case should be based on the treatment provided for similar or related items of cost. In case of a discrepancy between the provisions of a specific sponsored agreement and the provisions below, the agreement should govern.

## **III. OMB Circular A-21 Section J – Allowable and Unallowable Costs.**

Section J of A-21 spells out the allowable and unallowable costs and exceptions.

**J.1. ADVERTISING AND PUBLIC RELATIONS** – Allowable only if related to and necessary for performance of the project (i.e., disposal of surplus materials) or advertising for a position.

**J.2. ADVISORY COUNCILS** – Allowable as a direct cost where authorized by awarding agency; otherwise as an indirect cost.

**J.3. ALCOHOLIC BEVERAGES** – Unallowable

**J.4. ALUMNI ACTIVITIES** – Unallowable

**J.5. AUDIT COSTS AND RELATED ACTIVITIES** – Allowable as a direct cost when approved by the awarding agency; otherwise as an indirect cost.

**J.6. BAD DEBTS** -- Unallowable

**J.7. BONDING COSTS** – Allowable pursuant to the terms of an award.

**J.8. COMMENCEMENT COSTS** – Unallowable

**J.9. COMMUNICATION COSTS** – Allowable as a direct cost for items such as long distance calls related to a project); otherwise an indirect cost for items such as recurring line charges, non-project long- distance calls)

**J.10. COMPENSATION FOR PERSONAL SERVICES** – Allowable (note: sabbatical leave is now covered under this section as well as fringe benefits, pension plans, institution-furnished vehicles and severance pay.

- J.11. CONTINGENCY PROVISIONS** – Unallowable except for self-insurance, pensions, severance and post-retirement health costs.
- J.12. DEANS OF FACULTY AND GRADUATE SCHOOLS** – Allowable as indirect
- J.13. DEFENSE AND PROSECUTION OF CRIMINAL AND CIVIL PROCEEDINGS, CLAIMS, APPEALS AND PATENT INFRINGEMENT** – Allowable, unless commenced by the federal, state or local government
- J.14. DEPRECIATION AND USE ALLOWANCES** – Allowable as an indirect cost
- J.15. DONATIONS AND CONTRIBUTIONS** – Unallowable
- J.16. EMPLOYEE MORALE, HEALTH, WELFARE COSTS** – Allowable as indirect
- J.17. ENTERTAINMENT COSTS** – Unallowable
- J.18. EQUIPMENT AND OTHER CAPITAL EXPENDITURES** – Allowable
- J.19. FINES AND PENALTIES** – Unallowable
- J.20. FUND RAISING AND INVESTMENT COSTS** – Unallowable except where incurred as a result of compliance with a sponsored agreement or written prior authorization by sponsoring agency.
- J.21. GAINS AND LOSSES ON DEPRECIABLE ASSETS** – Allowable as a credit or charge in the year of the property's sale, retirement or disposal.
- J.22. GOODS OR SERVICES FOR PERSONAL USE** – Unallowable
- J.23. HOUSING AND PERSONAL LIVING EXPENSES** – Unallowable
- J.24. IDLE FACILITIES AND IDLE CAPACITY** – Idle facility is unallowable; idle capacity is allowable as an indirect cost if reasonable
- J.25. INSURANCE AND INDEMNIFICATION** – Allowable if needed for a sponsored agreement (note: malpractice insurance is allowable cost of research programs only to the extent that the research involves human subjects)
- J.26. INTEREST** – Unallowable, except for interest on debt incurred after 7/1/82 to acquire buildings, major reconstruction and remodeling, or acquisition/fabrication of capital equipment costing \$10,000 or more
- J.27. LABOR RELATIONS COSTS** – Allowable
- J.28. LOBBYING** – Unallowable
- J.29. LOSSES ON OTHER SPONSORED AGREEMENTS OR CONTRACTS** – Unallowable
- J.30. MAINTENANCE AND REPAIR COSTS** – Allowable
- J.31. MATERIAL AND SUPPLIES COSTS** – Allowable as a direct cost along as necessary to carry out a sponsored agreement and actually used for the performance of a sponsored agreement
- J.32. MEETINGS AND CONFERENCES** – Allowable
- J.33. MEMBERSHIPS, SUBSCRIPTIONS AND PROFESSIONAL ACTIVITY COSTS** – Allowable, except for membership in civic/community, country club, social or dining clubs are unallowable
- J.34. PATENT COSTS** – Allowable if required by the sponsored agreement, except for foreign patents
- J.35. PLANT AND HOMELAND SECURITY COSTS** -- Allowable
- J.36. PREAGREEMENT COSTS** – Unallowable unless approved by the sponsoring agency
- J.37. PROFESSIONAL SERVICE COSTS** – Allowable
- J.38. PROPOSAL COSTS** – Unallowable

- J.39. PUBLICATION AND PRINTING COSTS** – Allowable as a direct cost if the costs can be identified with a research project, and if the cost is page charges, the charges are levied impartially on all research papers published, not just those funded by federally sponsored authors
- J.40. REARRANGEMENT AND ALTERATION COSTS** – Allowable, with prior approval of the sponsoring agency
- J.41. RECONVERSION COSTS** – Allowable
- J.42. RECRUITING COSTS** – Allowable if reasonable (color ads are not considered reasonable)
- J.43. RENTAL COSTS OF BUILDINGS AND EQUIPMENT** – Allowable
- J.44. ROYALTIES AND OTHER COSTS FOR USE OF PATENTS** – Allowable if necessary for the performance of an award
- J.45. SCHOLARSHIPS AND STUDENT AID COSTS** – Allowable only when the purpose of the sponsored agreement is to provide training to selected participants and the charge is approved by the sponsored agency
- J.46. SELLING AND MARKETING** – Unallowable
- J.47. SPECIALIZED SERVICE FACILITIES** – Allowable, but rates must be adjusted at least biennially and have to take over/under applied costs of the previous period(s) into consideration
- J.48. STUDENT ACTIVITY COSTS** – Unallowable
- J.49. TAXES** – Allowable when the institution is required to pay
- J.50. TERMINATION COSTS APPLICABLE TO SPONSORED AGREEMENTS** – Allowable if for a sponsored project
- J.51. TRAINING COSTS** – Allowable, as indirect
- J.52. TRANSPORTATION COSTS** – Allowable
- J.53. TRAVEL COSTS** – Allowable, but must be reasonable (must be lowest commercial airfare—coach or equivalent)
- J.54. TRUSTEES** – Allowable, as indirect