

## ALLOCATION AND CHARGING OF DIRECT AND INDIRECT COSTS AT THE UNIVERSITY OF ROCHESTER

### OVERVIEW

Federal regulation mandates that universities establish consistent practices for defining and charging costs either directly or indirectly. The University of Rochester has implemented policies and issued guidelines on proper charging of costs, including the *Implementation of Revisions to OMB Circular A-21 (December 27, 1993)* that prohibits the direct charging of administrative costs to federal awards.

The following material supplements existing University policy and outlines practices that must be consistently applied, in like circumstances, throughout the University of Rochester for both sponsored and institutional accounts. This guidance has been established to meet the compliance standards set forth in OMB Circular A-21, *Cost Principles for Educational Institutions*, OMB Circular A-110, *Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education* and the Cost Accounting Standards (CAS) applicable to educational institutions<sup>1</sup>. It is the responsibility of principal investigators, department heads and administrators to understand and comply with this guidance in order to prevent cost disallowances by the federal government. Consistent treatment of costs is necessary to meet the ultimate objective of CAS 502 which is to prevent overcharging the federal government and double counting.

### DEFINITIONS

- **Allocable Costs:** Costs of goods or services that are chargeable or assignable to a specific project, function, department, or unit based on the relative benefits received or other equitable relationship of the goods and services to the specific project, function, department or unit.
- **Direct Costs:** Direct costs are costs that can be specifically identified and assigned with *relative ease* and with a *high degree of accuracy* to federally sponsored projects, or institutional accounts that charge federally sponsored projects such as service centers or fully-costed shops.
- **Indirect Costs:** Indirect costs (also called Facilities and Administrative costs) are general institutional expenditures that are incurred for multiple or shared projects, functions or activities and therefore cannot be specifically identified with relative ease and with a high degree of accuracy to a sponsored project, an instructional account, or any other institutional account.

Indirect costs are incurred in the following areas:

- Depreciation, maintenance, and utilities for University buildings and equipment;
  - Academic colleges and departments for the administrative effort of clerical, faculty and other professional personnel involved in various missions of the unit;
  - Expenses for offices which serve the entire University, such as the President's Office, Human Resources, Purchasing and Finance;
  - Central operations such as facilities management, telecommunications, sponsored projects administration and libraries
- **Indirect Cost Rate:** A composite rate applied to sponsored projects as a percentage of the sponsored project's direct costs. The federally negotiated indirect cost rates for organized research are developed by the University in accordance with OMB Circular A-21 and negotiated with the Department of Health and Human Services, the University's federal cognizant audit agency.

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<sup>1</sup> The standards that are applicable to educational institutions are CAS 501- Consistency in Estimating, CAS 502 - Consistency in Allocating Costs incurred for the same purpose, CAS 505 - Accounting for Unallowable Costs and CAS 506 - Consistency in Accounting Period.

- **Service Centers and Department Recharge Accounts:** A University of Rochester unit that sells goods and services predominately to colleges or departments within the institution. Service centers and department recharge accounts must adhere to the University's *Service Center Guidelines* in the development and billing of their rates. Rates for service centers and recharge accounts are reviewed and approved annually by the Budget Office.
- **Sponsored Projects:** Projects funded by federal and nonfederal agencies and administered by the Office of Research and Project Administration (ORPA) and Office of Research Accounting and Costing Standards (ORACS). Sponsored projects include grants, contracts and cooperative agreements for research, clinical trials, training and public service activities. Sponsored projects are assigned to ledger 5 (restricted) accounts.

## CHARGING DIRECT COSTS

The major criterion for direct charging of costs to sponsored agreements is the *identification of a given cost* with the sponsored work rather than the nature of the goods and services involved. In order for expenditures to be considered as direct costs, they must be:

- **Reasonable and necessary** for the performance of the project;
- **Allowable** – Costs that are specifically allowed under the terms and conditions of federally sponsored projects and OMB Circular A-21;
- **Allocable and easily identifiable** – The costs must have a direct benefit and be directly attributable to the project or activity being performed.

Costs incurred for multiple projects/activities must be identified as follows:

- If the cost is specific and benefits more than one project, the cost can only be assigned and allocated to the project(s) based on that portion of the expense that represents the direct benefit to the project. This allocation of costs should be made at the time of purchase. If an appropriate basis such as actual usage cannot be identified to allocate the costs with *relative ease* and with a *high degree of accuracy*, such costs must be considered indirect costs. As a rule of thumb, if these costs benefit multiple (e.g., four or five) projects/activities, the ability to accurately allocate the cost to the appropriate projects/activities diminishes and therefore becomes questionable as a direct cost.
- If the benefit is spread over multiple projects to serve common shared activities and it is difficult to identify a direct benefit to each activity or project, the cost must be considered an indirect cost.

## Unacceptable Direct Cost Charging Practices

The following examples are unacceptable practices of direct charging:

- Rotating charges among projects without establishing that the charges accurately reflect the relative benefit to each project during that specified period of time;
- Allocating indirect expenses directly to a project;
- Transferring expenses from other accounts at the end of a project period for the sole purpose of expending a residual balance.

## UNALLOWABLE COSTS

In accordance with OMB Circulars A-21 and A-110, the federal government will not reimburse universities for certain costs that it considers unallowable. These costs cannot be included in the development of the indirect cost rate, charged as a direct cost to federally sponsored projects, or included in University service center rates. Such costs include alumni activities, development and fund raising, entertainment and lobbying. All costs identified in A-21 as unallowable must be charged to non-federal accounts and appropriate subcodes as defined in the University's *Accounting Manual*.

As stated in the *University Implementation of OMB Circular A-21*, certain costs such as secretarial and administrative salaries, office supplies, postage, memberships and local telephone costs are normally considered indirect costs and are not allowable as direct charges to federal awards.<sup>2</sup>

## SPECIAL CIRCUMSTANCES

As stated in OMB Circular A-21, similar costs incurred in like circumstances must be consistently treated as either direct or indirect. However, some costs may be charged as both direct and indirect depending upon the particular purpose or the circumstances of the expense. Size, nature and complexity of federally sponsored projects, are important considerations in determining circumstances where exceptions are justified. The principal investigator, with the assistance of the department administrator and ORPA, must determine if the indirect-type cost is necessary for the conduct of a federally sponsored project. These special circumstances must be documented and justified in the budget narrative at the proposal stage or with associated expense documentation during the term of an existing award.

## TYPICAL DIRECT AND INDIRECT COSTS

In order to assist principal investigators and administrators in determining direct and indirect costs at the University of Rochester, the attached matrix has been developed. Any questions pertaining to the correct charging of costs should be referred to ORPA - [Gunta Liders](#) or ORACS - [Jeff Sullivan](#).

Attachment:      1) Typical Direct and Indirect Costs  
                      2) Exhibit C of OMB Circular A-21

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<sup>2</sup> For more information on the charging of administrative and clerical costs, refer to Exhibit C of OMB Circular A-21.

## Typical Direct and Indirect Costs

Direct	Indirect
<p><b>Salaries &amp; Wages/Fringe Benefits</b> Faculty, technicians, scientists, research assistants, postdoctoral associates, or other programmatic personnel who are necessary to accomplish the goals of the project.</p> <p><b>Computer Costs</b> (software, supplies and services)</p> <p><b>Long Distance Telephone Charges</b></p> <p><b>Scientific &amp; Technical Equipment</b></p> <p><b>Maintenance agreements</b> related to scientific and technical equipment</p> <p><b>Materials</b> (including noncapitalized equipment)</p> <p><b>Participant Expenses</b> (NSF awards)</p> <p><b>Lab Supplies</b> (items solely consumed by the project)</p> <p><b>Services Obtained:</b></p> <ul style="list-style-type: none"> <li>• <b>Animal Care/Vivarium</b></li> <li>• <b>Outside vendors</b></li> </ul> <p><b>Consultant/Professional services</b></p> <p><b>Subcontracts</b></p> <p><b>Human Subjects Fees</b></p> <p><b>Travel</b></p> <p><b>NOTE:</b> Costs normally charged indirect are charged direct when:</p> <ul style="list-style-type: none"> <li>• There is a functional difference in the work performed by individuals in the same job classification</li> <li>• Size, nature and complexity goes well beyond normal departmental support <u>Examples:</u> center awards, epidemiology studies, clinical trials, multidisciplinary awards</li> <li>• The cost is incurred for the sole benefit of a grant, e.g., mailing a progress report to a sponsor</li> <li>• Costs listed as “indirect” can be charged direct on nonfederal agreements</li> </ul>	<p><b>Salaries &amp; Wages/Fringe Benefits</b> Clerical and administrative positions such as fiscal officers, accountants, secretaries, directors, vice presidents, president, office personnel, executive assistants, and administrators.</p> <p><b>Telephone</b> (data lines, equipment, recurring, installation and maintenance)</p> <p><b>Equipment</b> (office and general purpose)</p> <p><b>Janitorial Services</b> <b>Sanitation Services</b> (including hazardous waste) <b>Repair &amp; Maintenance</b> (buildings, grounds, equipment, remodeling, etc.)</p> <p><b>Subscriptions, Library Books, Periodicals, etc. Postage</b></p> <p><b>Memberships</b></p> <p><b>Office Supplies</b> <b>Photocopy</b> (for general office use)</p> <p><b>Utilities</b></p> <p><b>Recruitment Travel</b></p> <p><b>NOTE:</b> Costs listed in “Direct” become indirect when they are for general institutional purposes or support multiple project/activities, and they cannot be identified with relative ease and with a high degree of accuracy with those projects/activities</p>

## **Exhibit C -- Examples of "major project" where direct charging of administrative or clerical staff salaries may be appropriate**

- Large, complex programs such as General Clinical Research Centers, Primate Centers, Program Projects, environmental research centers, engineering research centers, and other grants and contracts that entail assembling and managing teams of investigators from a number of institutions.
- Projects which involve extensive data accumulation, analysis and entry, surveying, tabulation, cataloging, searching literature, and reporting (such as epidemiological studies, clinical trials, and retrospective clinical records studies).
- Projects that require making travel and meeting arrangements for large numbers of participants, such as conferences and seminars.
- Projects whose principal focus is the preparation and production of manuals and large reports, books and monographs (excluding routine progress and technical reports).
- Projects that are geographically inaccessible to normal departmental administrative services, such as research vessels, radio astronomy projects, and other research fields sites that are remote from campus.
- Individual projects requiring project-specific database management; individualized graphics or manuscript preparation; human or animal protocols; and multiple project-related investigator coordination and communications.

These examples are not exhaustive nor are they intended to imply that direct charging of administrative or clerical salaries would always be appropriate for the situations illustrated in the examples. For instance, the examples would be appropriate when the costs of such activities are incurred in unlike circumstances, i.e., the actual activities charged direct are not the same as the actual activities normally included in the institution's facilities and administrative (F&A) cost pools or, if the same, the indirect activity costs are immaterial in amount. It would be inappropriate to charge the cost of such activities directly to specific sponsored agreements if, in similar circumstances, the costs of performing the same type of activity for other sponsored agreements were included as allocable costs in the institution's F&A cost pools. Application of negotiated predetermined F&A cost rates may also be inappropriate if such activity costs charged directly were not provided for in the allocation base that was used to determine the predetermined F&A cost rates.