Direct & Indirect Cost Primer

Presentation to School of Biomedical Engineering,
Science and Health Systems Faculty

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The Golden Rule

The basic principle is that costs charged to a sponsored project must be allocable, allowable, reasonable and necessary, and treated consistently.

Allocable Costs

- A cost is *allocable* to a particular project when it has a direct benefit and can be directly attributable to the project or the activity being performed.

- For example, an investigator purchases equipment to conduct a sponsored project. The equipment is *allocable* to the project as a direct cost.

- The investigator also purchases office supplies for the entire department. These supplies are not directly attributable to the project and are therefore *not allocable* and may not be charged as a direct cost to the project.

Allowable Costs

- The cost must be allowed by University policy, sponsor policies, and OMB Circular A-21.

- For example, an investigator has a post doc working on the project. This is an _allowable_ direct cost of the project.

- The investigator takes the post doc out to dinner during the project and discusses the project during dinner. Meal expenses are not allowable under OMB Circular A-21 (Section J.17). Therefore, this is an _unallowable_ cost and may not be charged to the project.

Is the Cost Necessary?

- The cost must be *reasonable and necessary* for the performance of the project.

- For example, an investigator purchases lab supplies to complete the work on the project. The supplies are *reasonable and necessary* to the performance of the project and can be charged as direct costs.

- The investigator also purchases a microscope that was on sale when he purchased the supplies. The microscope is not needed for his current project but may be needed for an upcoming project. This expense is *not reasonable and necessary* for the performance of the current project and may not be charged as a direct cost of the project.
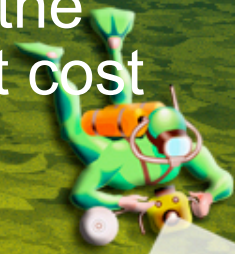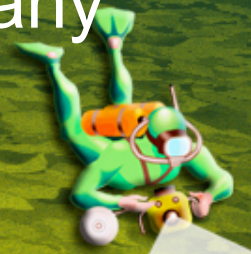
Be Consistent

- Costs incurred for the same purpose in like circumstances must be treated *consistently* as either direct or indirect costs.

- This means that where we treat 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 for all university activities.

Direct vs. Indirect Costs

- *Direct Costs* are those costs that can be identified specifically with a particular sponsored project, instructional activity, or any other institutional activity, or that can be directly assigned to such activities relatively easily with a high degree of accuracy.

- *Facilities and Administrative (Indirect) Costs* are those that are incurred for a common or joint purpose and therefore cannot be identified readily and specifically with a particular sponsored project, instructional activity, or any other institutional activity.

Is the Cost Consistently Treated?

- Costs incurred for the same purpose, in like circumstances, must be *consistently treated* as either direct costs or indirect costs only. Otherwise, the University would risk double charging the government once by directly charging a cost to a sponsored project and again by including the same [type of] cost in the indirect rate charged to that sponsored project.

- For example, a Department Administrator purchases stamps for the department. Investigator A uses five stamps for various mailings related to his project and Investigator B uses eight stamps for various mailings related to her project. If the cost of the stamps is included as a direct cost to Investigator A or B's sponsored project, and similar costs (stamps) incurred in like circumstances (general purpose) are included in the Department Administration component of the University's F&A rate, the costs *are not treated consistently*.

Normally Direct Costs

- Salaries of those working directly on the project
- Lab supplies
- Long distance phone calls
- Postage for mailing project surveys and questionnaires (unlike circumstances)
- Scientific equipment and software
- Travel

Normally Indirect Costs

- Time spent writing proposals.
- Administrative and clerical time.
- General purpose equipment and software.
- General purpose computers and laptops.
- Space and utility costs.
- General purpose office supplies.
- Postage for routine correspondence.
- Local telephone and basic line charges.
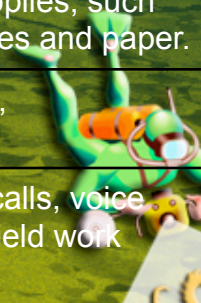- Subscriptions, dues and memberships.

Unlike Circumstances

- In some circumstances, expenses normally charged as indirect may be charged to the project as direct costs. Additional documentation is required to show the *unlike circumstances.*

- For example, large complex projects that involve extensive data accumulation or surveying may require administrative costs well beyond those needed for most projects. Generally, the *special need* will have been <u>justified in the proposal budget and approved by the sponsor</u>.

Cost Matrix-Short Version

Normally Direct Costs	Normally Indirect Costs
Salaries, wages, fringe benefits, such as: investigator, research assistant or associate, scientist, technician, post doc, graduate research assistant	Salaries, wages, fringe benefits, such as: department administrator, secretary, clerk
Express service for overnight, federal express, Priority Mail, UPS, freight, delivery when needed to transport project material or report in a non-routine manner	Express service for routine delivery of project material or report
Postage for mailing a large quantity of questionnaires, research surveys to accomplish project goals	Postage for routine sponsored project correspondence
Printing to produce bound manuals or print project-related manuscripts and large reports	Routine printing, reproduction, photocopying
	Organizational memberships
	Books and subscriptions
Scientific computer software and computers used solely for the project	General purpose computer software and supplies, such as word processing programs, toner cartridges and paper.
	General office supplies, paper, pencils, pens, transparencies, tablets, binders, etc.
Long distance telephone charges and project-dedicated field work phones	Basic telephone line charges, pagers, local calls, voice mail, cellular phones unless project-related field work phone

Unallowable Costs

- Entertainment
- Meals not associated with travel
- Beer, wine and spirits
- Time spent writing new proposals
- Costs associated with obtaining grant funding, such as lobbying
- Gifts, rewards and promotional activity

Unacceptable Direct Costing Practices

- Rotating charges without establishing the direct benefit to each project.

- Assigning costs to the project with the largest budget or available balance.

- Charging the budgeted amount rather than an actual usage amount.

- Describing a cost as something other than what it is.

Financial Management Begins With?

- The Principal Investigator
- The Department Administrator
- The Department Chair
- The University

Monitoring Costs

- Periodically compare actual expenses to budgeted expenses.

- Review expenses to be sure they are accurate, reasonable and allowable.

- Correct mischarges in a timely manner via cost transfers.

- Obtain prior approvals when required.

- Monitor subrecipient costs too.

Budget vs Actual Costs

- Compare actual expenses to budgeted expenses at least monthly to ensure:
  - ✓Expenditures are reflective of actual work performed – the "burn rate".
  - ✓You have not spent more in total funds on the project than was awarded.
  - ✓Total expenditures for any cost category have not been exceeded if restricted on the notice of grant award.

Accurate Charges

- Review actual expenses at least monthly to ensure they are:
  - ✓ Accurate
  - ✓ Reasonable
  - ✓ Allocable
  - ✓ Allowable
 - ✓ Consistently applied

Fixing Errors

- Cost transfers correct posting errors, and remove unreasonable, unallocable, unallowable or inconsistently applied charges from the project. Cost transfers raise audit flags, require additional scrutiny, and double the work.

- Document the reason for the error as well as the reason why the charge is appropriate for the project.

- Make the correction in a timely manner.

Why is a Cost Transfer Policy Important?

Frequent, late, and inadequately explained cost transfers, especially those involving projects with cost overruns or unexpended balances, raise serious questions about the propriety of the transfers and call internal fiduciary controls into question. This may result in audit disallowances and monetary paybacks including penalties and fines.
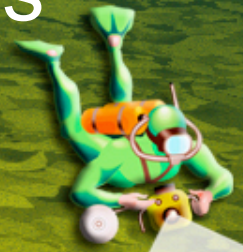
Costing Policy

Drexel's Costing Policy is located at: http://www.drexel.edu/research/orca/Policies/costing_policy.asp?school=Drexel

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