

HOW TO DISTINGUISH BETWEEN DIRECT AND INDIRECT CHARGES

Vincennes University

Purpose

As a recipient of federal funds, the Office of Management and Budget (OMB) Circular A-21, Cost Principles for Educational Institutions set the standards for grants and defines what costs are allowable. These regulations also require Institutions to classify costs either as direct or indirect costs.

Once costs are classified, Institutions are required to treat the same type of cost, in like circumstances, in a consistent manner. Consistent treatment of costs is a basic cost accounting principle and is specifically required by OMB Circular A-21 to assure that the same types of costs, in like circumstances are not charged to grants both as direct and indirect costs. This requirement ensures that the sponsor is not paying twice for the same type of costs in like circumstances.

Responsibility

Project Managers are expected to apply this guidance document when charging direct or indirect costs to grants.

Definitions

Allocable - The cost must have a direct benefit and be directly attributable to the project or activity being performed. For example, a Project Manager purchases a piece of equipment in order to conduct a grants. This piece of equipment is allocable to that project and can be charged as a direct cost to the project.

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

Consistent: In this context means that costs incurred for the same purpose, in like circumstances, must be treated uniformly either as direct costs or indirect costs.

Allowable Costs: Costs that are allowed to be charged to grants per OMB Circular A-21. For a cost to be allowable as a direct charge it must be: Necessary, Reasonable, Non-Personal, Allocable, Consistently Treated, and Well Documented. Any expense that does not meet all of these criteria should not be directly charged to a grant. Note that approval of a particular expense as a direct cost by the granting agency does not guarantee that the expense constitutes an allowable cost.

Direct Costs: Allowable costs that can be identified specifically with a particular grants(s) and directly assigned with a high degree of accuracy.

Indirect Cost (F&A): Allowable costs that are incurred for common or joint objectives and therefore cannot be identified readily and specifically with one grants or proportionally charged to multiple grants (i.e. payroll department salaries).

How to Allocate Charges

Rules of Allocation

If the expenditure solely benefits one project, it should be charged entirely to that project. However, sometimes expenditures (i.e. supplies, equipment) can benefit two or more projects, or even other educational activities not supported by a grants. When this occurs, charges that benefit more than one project or activity must be allocated on the basis of proportional benefit or on a reasonable basis.

OMB Circular A-21 provides two rules that apply when allocating allowable direct costs that benefit more than on grants:

Rule of Proportional Benefit

If a cost benefits two or more projects or activities in proportions that can be determined without undue effort or cost, the cost should be allocated to the projects based on the proportional benefit.

Rule of Interrelationship

If a cost benefits two or more projects or activities in proportions that cannot be determined because of the interrelationship of the work involved the costs may be allocated or transferred to benefited projects on any reasonable basis.

Refer to Appendix A for an illustration of the cost allocation process.

Examples of Acceptable Allocation Methods

Usage Based: The cost of long distance telephone charges allocated based upon the quantity used on each project or documented usage of the phone.

Time Based: The cost of computer equipment allocated based upon the number of hours used for each project.

Effort Based: The cost of supplies proportionately allocated based upon the percentage of effort of the staff charged to each project.

Square Footage Based: This method can be used for programs that directly charge facility costs, such as utilities. The utility expenses can be charged based on square footage of the program occupying the space.

Other reasonable methodologies can be developed, provided that they meet the A-21 allocation principles. Contact the Grant Office for help in developing other allocation methods if proportions that cannot be determined because of the interrelationship of the work involved.

Documentation

Allocation methodologies must be documented and auditable when employed. Documentation should indicate how the allocation methodology is logically related to the cost being allocated. This documentation must be retained by Project Manager.

Unacceptable Allocation Practices Include:

- Shifting expenditures to other grants in order to meet deficiencies, to avoid restrictions imposed by law or terms, or for other reasons of convenience.
- Charging expenses that benefit two projects solely to one project because the other project is almost out of funding.
- Purchasing items simply to use a remaining balance.
- Rotating charges among projects.
- Charging an expense to one project when the expense has benefited more than one project or other activities.

Cost Allocation Process – Appendix A



