

# Background Information on Direct Costs and Allowable Costs

## Direct Costs

Direct costs are those costs incurred specifically for the benefit of a particular activity. Direct costs can be identified easily and accurately to an individual project. Typical transactions chargeable to sponsored projects as direct costs are the compensation of employees for the time or effort devoted to the performance of the work, including related staff benefit and pension plan costs; the cost of materials consumed or expended in the performance of the work; and, other items of expense incurred specifically for sponsored projects.

Direct costs must be charged to the project for which the expenditure was incurred. The availability of funds within an account should not be the determining factor for funding expenditure. Likewise, the offsetting of costs between projects (i.e., rotating supply purchases between projects) to simplify cost distribution is not a permissible practice. The cost benefit relationship between the item and the sponsored project must be demonstrated. To be allowable (i.e., in order to be charged to the sponsored account), the cost must be incurred within the approved project period and within limitations prescribed by the contract or grant award. In some instances, awarding agencies may limit costs, for example the NIH salary cap. Where costs are limited by the sponsoring agency, but are incurred in support of the project, the costs should be captured as voluntary cost sharing.

Information regarding the allocability of these types of charges is located in the [Cost Allocation Guidelines for Charges to Sponsored Programs](#) document also located [University CAS Guidelines website](#).

## Allocable Costs

Simply stated, cost allocation is the process of assigning charges to accounts in accordance with the relative benefits received. Costs may be assigned (or allocated) to an account by the Principal Investigator as direct charges. Other costs are assigned to a sponsored program account through the application of the University's facilities and administrative rate. The rules for cost allocation clearly state that similar costs, in like circumstances, must be allocated consistently as either direct costs or indirect costs. That is, costs that are normally assigned by the Principal Investigator as direct charges to sponsored accounts should not be included in the facilities and administrative rate. Likewise, costs normally included in the facilities and administrative rate cannot be assigned by the Principal Investigator as direct charges unless unusual circumstances exist and are sufficiently documented. The specific rules regarding direct costs are contained in the next section of this document.

The key regulatory language and interpretations to illustrate cost allocation are provided below. The cost accounting standards state that: "Allocation means the process of assigning a cost, or a group of costs, to one or more cost objectives, in a reasonable proportion to the benefit provided or other equitable relationship.

The Uniform Guidance, section 200.405 – Allowable Costs states that: A cost is allocable to a particular cost objective (i.e., a specific function, project, sponsored agreement, department, or the like) if the goods or services involved are chargeable or assignable to such cost objective in accordance with the relative benefits received.

Uniform Guidance, section 200.405 - Allowable Costs further prescribes that: If a cost benefits two or more projects or activities in proportions that can be determined without undue effort or cost, the cost must be allocated to the projects based on the proportional benefit. If a cost benefits two or more projects or activities in proportions that cannot be determined because of the interrelationship of the work involved, then, notwithstanding the overcoming insufficient funds availability, avoiding restrictions/regulations or terms and conditions of the award, the costs may be allocated to benefiting projects on any reasonable, documented basis.

Therefore, the Uniform Guidance has described a two-step decision process. Can the proportional benefit be determined? If yes, then assign the cost on the proportional benefit. If the proportional benefit cannot be determined, are the projects interrelated? If yes, the Principal Investigator may assign the costs on any reasonable, documented basis. When the proportional benefit can't be determined and the projects are not interrelated then the cost can't be charged as a direct cost.

Questions about these guidelines should be directed to your Post Award Administrator or the Research Quality Assurance Office.