Information
Charging Direct Costs to Sponsored Programs

Effective
January 1, 2017

Number
RES-2.06a

Applicability
This policy applies to University Employees (Administrators, Faculty, and Staff).

Administrative Authority
Executive Vice President for Research and Innovation

Responsible Unit
Compliance and Operational Support Core
Office of Sponsored Programs Administration
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History
Revision Date(s): May 14, 2021; September 28, 2021; May 16, 2022
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Categories

Statement:

I) Introduction
All direct costs charged to sponsored programs must be charged in a timely manner and must be:

- **Allowable:** under both the provisions of federal guidance AND the terms of a specific award/agreement;
- **Allocable**: the expense can be associated to a project or program with a high degree of accuracy and in accordance with relative benefits received;
- **Necessary**: costs must be necessary and directly related to the performance of the sponsored program;
- **Reasonable**: the cost reflects what a "prudent person" would pay in a similar circumstance; and
- **Adequately Documented**.

Any expense that does not meet all of these criteria cannot be charged to a sponsored program.

II) Budgeting and Classification of Direct Costs

An expense is a "direct cost" if that expense can be identified specifically with a particular sponsored program or other activity with a high degree of accuracy. "Indirect costs" (sometimes referred to as facilities and administrative (F&A) costs or overhead) are costs that benefit many activities (e.g., administrative costs, building operations and maintenance, IT expenses, security, etc.). "Indirect costs" represent real costs and are recovered through the University's federally negotiated rate agreement. Costs incurred for the same purpose in like circumstances must be treated consistently as either direct costs or indirect costs.

Typical direct costs that may be charged to a sponsored program include, the compensation of technical staff who work on the project, laboratory supplies (e.g., chemicals), special purpose equipment, animals, animal care costs, and travel costs. Indirect costs that typically cannot be charged directly to a sponsored program include, general and office supplies, photocopies, postage, local telephone costs, and the compensation of administrative and clerical personnel.

The Direct Cost Allowability Matrix provides authoritative guidance regarding the allowability of specific costs as direct charges to sponsored programs. Principal Investigators (PIs) are responsible for ensuring that all costs included as direct costs in proposal budgets comply with the Direct Costs on Externally Sponsored Programs policy.

As mentioned above, costs must consistently be treated as direct expenses or

indirect costs when the costs are incurred for similar purposes and circumstances. However, in some instances ("unlike purpose and circumstance"), costs normally considered indirect costs may be allowable as direct costs if they meet all three of the following criteria:

- An unlike circumstance exists in which a sponsored program requires resources beyond those normally expected for a typical sponsored program;
- The costs can be associated with the specific sponsored program with a high degree of accuracy; and
- The sponsor has approved the cost as a direct expense in the awarded budget. For any such cost that was not included in the awarded budget, the Principal Investigator must provide contemporaneous justification as to how the cost is used to meet the technical needs of the sponsored program and its relevance to the methods used in conducting the project. All such costs at and above $1,000 require written sponsor approval prior to expenditure.*

* Please refer to the Direct Cost Allowability Matrix for additional information.

When preparing proposals/applications for sponsored programs, the Principal Investigator should develop and submit a detailed budget and budget justification including salaries and wages, fringe benefits, travel, supplies, and other direct costs. When "unlike purposes and circumstances" exist and the PI wishes to charge costs typically categorized as indirect costs to the sponsored program as direct costs, these costs must be explicitly included and justified in the budget narrative. Only those direct costs that are included in an approved budget should be charged to an award as direct costs. If a cost requires institutional and/or sponsor prior approval after an award is made, that approval must be secured before the cost is incurred. Any cost typically categorized as an indirect cost that is not included in the awarded budget requires prior written sponsor approval, if significant.

When budgeting for the compensation of administrative and clerical personnel (typically treated as indirect costs), Principal Investigators should follow the Guidance for Direct Charging of Administrative and Clerical Salaries to Sponsored Programs.

For projects with non-federal sponsors that permit the direct charging of costs typically categorized as indirect costs (e.g., administrative costs): All costs that can be specifically identified with the sponsored program should be budgeted and

adequately justified in the proposal.

III) Justifying Proposed Costs

All costs typically categorized as indirect costs that are included as direct costs in a proposal budget must be explicitly justified in the budget narrative. When justifying such costs, Principal Investigators should consider and address the following issues:

- How does the proposed cost meet a specific need of the project? What is the benefit of the cost to the project?
- Considering that all sponsored programs require a certain amount of indirect costs (e.g., personnel to perform account reconciliation, general correspondence, telephone use, office supplies, etc.), how does the proposed cost differ from the standard level expected for all sponsored programs?
- When including costs for administrative and clerical personnel: Is the nature of the work different from the general administrative work conducted for all sponsored programs? Are the costs necessary to meet the technical aims and objectives of the award rather than to support the administrative needs?
- When including costs for general and/or office supplies: How will these items be used to meet the objectives of the sponsored program? Explain in detail their relevance to the methods used in conducting the project.
- Can the proposed costs be easily and accurately documented as allowable on and allocable to the sponsored program? How will this be done? For example, an administrator working full-time on a sponsored program can be allocated easily and accurately to the project. However, if that person works on five or more projects, it will be difficult to accurately document the relative benefit to any one specific project.

IV) Charging Direct Expenses

Principal Investigators are responsible for ensuring that all direct costs charged to sponsored programs comply with the Direct Costs on Externally Sponsored Programs policy.

An award for a sponsored program will include a budget approved by the sponsor. Upon receipt of an award, the Principal Investigator will be requested to disclose and justify any costs - that are typically treated as indirect costs - which he/she plans to charge to the award as direct costs via the Cost Accounting Standard (CAS)

disclosure form. Only those costs that are included in the approved budget and/or documented on an approved CAS disclosure form should be charged to the award as direct costs.

Typically, a sponsored program will recover Facilities and Administrative (F&A) costs through the application of the University's federally negotiated rate. A percentage of these recovered costs is provided to Principal Investigators and Co-Investigators via Individual Research Infrastructure Funds (RIF). Any/All costs that are not included in an approved budget and/or CAS disclosure should be charged to RIF accounts or other unrestricted, non-sponsored program accounts.

All direct costs charged to sponsored programs must be charged in a timely manner. Certain direct charging practices are unacceptable including:

- Purchasing items simply to use an unobligated balance (e.g., Purchasing supplies or equipment at the end of a sponsored program).
- Rotating costs among multiple sponsored programs.
- Charging the budgeted amount (in contrast to charging an amount based on actual costs/usage).
- Assigning charges to a sponsored program before the cost is incurred (except as an encumbrance).
- Charging an expense exclusively to a sponsored program when the expense supports multiple activities/projects.
- Applying a "departmental tax" to projects for any reason.

V) Allocating Direct Expenses

Whenever possible, specific direct costs should be individually charged to a specific sponsored program. When it is not possible or efficient to determine how much of a cost is used for each sponsored program, allocation of the expense is appropriate. Allocation is the process of assigning a cost to one or more projects or activities in reasonable and realistic proportion to the benefit provided to each individual project or activity.

Allocation methodologies should meet all of the following criteria:

- The allocation should provide a reasonable linkage between the direct cost incurred and the benefit to each specific sponsored program.

- The allocation methodology should be identified in advance and documented in a way that a person unfamiliar with the management of sponsored programs would understand.
- Each allocation methodology should be applied consistently for similar costs.
- The allocation methodology should be reviewed and adjusted periodically.

Once an allocation methodology has been determined, it must be documented and the documentation retained by the Principal Investigator and/or department/center/institute. Documentation should include the costs to be allocated and the basis for distribution, including any justification and calculations.

Allocation methodology best practices include:

- Ensure that the allocation methodology is documented prior to, or contemporaneously with, the costs being incurred and allocated.
- When using percentages in allocation calculations, use actual figures as opposed to backing into a percentage based upon availability of funds.
- Document how measures, such as headcount, logically relate to the costs being allocated and the benefit received by the project.
- Retain the supporting documentation in the department (in accordance with the University's Retention of Records policy) so it is available for review and audit.
- Review allocation methodologies periodically to ensure they are reasonable.
- Do not use any allocation methodology that is based on available sponsored funds, budgets, or to avoid restrictions imposed by law, terms of the sponsored program, or for other reasons of convenience.
- Do not allocate expenses after the fact by use of cost transfers without appropriate documentation and justification.

VI) Documenting and Justifying Direct Expenses

Holistic documentation is required to justify any and all expenses charged to a sponsored program. The backup documentation for expenditures should be adequate to support and justify that:

- The expense provides a direct benefit to the sponsored program.
- The expense complies with any award restrictions and approval requirements outlined in the terms and conditions of the award.
- If applicable, the expense qualifies as "unlike purpose and circumstance" and was approved by the sponsor and/or institution (see sections II and IV above).

Special documentation is required under certain circumstances. For example, travel expenses require documentation that the travel is necessary and provides a direct benefit to the project. Documentation and justification must be maintained in accordance with the University's Retention of Records policy or with the requirements of the sponsored award, whichever is the longest.

VII) Monitoring Expenses

The University's financial system-of-record, PeopleSoft, is to be utilized by Principal Investigators and departmental business administrators to monitor expenditures placed on each sponsored program. Each sponsored account should be reconciled to the PeopleSoft system on a monthly basis in accordance with the University's Account Reconciliation Policy. Principal Investigators and departmental business administrators are responsible for review of compliance with federal cost principles as part of the monthly reconciliation process. The monthly account reconciliation process is an integral internal control over allowable costs.

VIII) Disposition of Unallowable Expenses

Costs determined to be unallowable as direct costs will be charged or transferred to the Principal Investigator's RIF account or other unrestricted, non-sponsored program account. Expenses that are collected from the sponsor and later determined to be unallowable must either be refunded to the sponsor or offset in the award by an allowable expense.

For example, following reports of non-compliance, animal costs that were charged to a sponsored program account related to activities unauthorized in the approved IACUC protocol will be transferred to a non-sponsored program account, for the period of non-compliance.

IX) Escalation Process for Disagreements

The Direct Cost Allowability Matrix provides authoritative guidance regarding the allowability of specific costs as direct charges to sponsored programs. In instances in which a Principal Investigator has questions or does not agree on the treatment of specific expenses, the PI should first seek guidance from his/her departmental research and/or business administrator and/or college/school/unit research office.

If the issue remains unresolved, the Principal Investigator may request the review of

his/her Research Dean who may subsequently request review by the Director of the Office of Sponsored Programs Administration (SPA) and the Assistant Vice President for Research and Innovation (AVPRI). The Research Dean, Director of SPA, and AVPRI will make a final determination on the treatment of the expense and the expense will be dealt with in accordance with this determination. All determinations are considered final and will be documented for the sponsored program file.

X) Contacts

If you have any questions regarding the allowability of specific expenses please contact:

- Your departmental research or business administrator.
- Your college/school/unit research office.
- Brigitte Fasciotto, PhD, Assistant Director OSPA - Compliance (502-852-7308, brigitte.fasciotto@louisville.edu).

Related Information:

Policy - Direct Costs on Externally Sponsored Programs