

Florida Atlantic University Allowability of Costs on Federal Awards

V. Basic Criteria for the Allowability of Costs on Federal Awards:

OMB Circular A-21, Section C lists the factors affecting the allowability of costs. Expenses must meet **ALL** of the following criteria in order to be considered allowable.

- A. Reasonable
- B. Allocable
- C. Consistent Treatment of Costs
- D. Conforming to Limitations
- E. Net of Applicable Credits

A. **Reasonable:** According to OMB Circular A-21, C 3:

A cost may be considered reasonable if the nature of the goods or services acquired or applied, and the amount involved therefore, reflect the action that a **prudent person** would have taken under the circumstances prevailing at the time the decision to incur the cost was made.

Costs should be reasonable in price, as well as in quantity, in order to accomplish the project's objectives. When determining reasonableness, the following questions should be asked:

1. Is the type of cost generally accepted as necessary ?

For example, first-class airfare is not allowable because this cost is clearly not necessary for the completion of the project. Therefore, first-class airfare is not considered to be reasonable. As a result, this expense is not allowable on federal awards. Section J 48 c. of OMB Circular A-21 expressly states that first-class airfare is unallowable, except in certain circumstances:

c. *Commercial air travel.* Airfare costs in excess of the lowest available commercial discount airfare, Federal Government contract airfare (where authorized and available), or customary standard (coach or equivalent) airfare, are **unallowable** except when such accommodations would: require circuitous routing; require travel during unreasonable hours; excessively prolong travel; greatly increase the duration of the flight; result in increased costs that would offset transportation savings; or offer accommodations not reasonably adequate for the medical needs of the traveler. Where an institution can reasonably demonstrate to the sponsoring agency either the nonavailability of discount airfare or Federal contract airfare for individual trips or, on an overall basis, that it is the

institution's practice to make routine use of such airfare, specific determinations of nonavailability will generally not be questioned by the Federal Government, unless a pattern of avoidance is detected. However, in order for airfare costs in excess of the customary standard commercial airfare to be allowable, e.g., use of first-class airfare, the institution must justify and document on a case-by-case basis the applicable condition(s) set forth above.

Another example of OMB Circular A-21 addressing reasonableness is in Section J 37 b and c:

b. In publications, costs of help wanted advertising that includes **color**, includes advertising material for other than recruitment purposes, or is **excessive in size** (taking into consideration recruitment purposes for which intended and normal institutional practices in this respect), are **unallowable**.

c. Costs of help wanted advertising, special emoluments, fringe benefits, and salary allowances incurred to attract professional personnel from other institutions that do not meet the test of **reasonableness** or do not conform with the established practices of the institution, are **unallowable**.

These types of excessive costs are expressly unallowable according to OMB Circular A-21. Every cost charged to a Federal award, either as a direct cost or included in the indirect cost pool, must be reasonable. These examples illustrate the spirit of the circular concerning the reasonableness of costs.

2. Were the requirements for "arms-length" bargaining met ?

For example, if the goods were purchased from a company owned by the PI's brother, it may be perceived that the purchase was not an "arms length" transaction. Any conflicts of financial interest should be disclosed according to University policy.

3. Did the individuals act with prudence under the circumstances ?

In other words, would the researcher feel comfortable if the costs spent on the project were reported on the front page of the local newspaper ? This example is called the "front page" test.

4. Is the cost consistent with FAU's policies, procedures, and practices ?

For example, FAU's policy is to submit a purchase requisition to the FAU Purchasing Department, which then issues a purchase order. There are specific purchasing procedures that must be followed. The PI should refrain from purchasing items on his or her own personal credit card and then requesting reimbursement from the University. Even though this

practice may be more convenient for the researcher, it is against University policy and not considered to be reasonable.

In addition, there are specific policies and procedures for using the University's P-cards for purchasing goods and services. The same rules must be followed for an account funded by a Federal award.

In addition, OMB Circular A-110, Section 44 addresses reasonableness, as follows:

44 [Procurement procedures.](#)

(a) All recipients shall establish written procurement procedures.

(1) Recipients **avoid purchasing unnecessary items**.

(2) Where appropriate, an analysis is made of lease and purchase alternatives to determine which would be the most economical and practical procurement for the Federal Government.

B. Allocable:

1. **In General:** According to OMB Circular A-21, Section C 4 a:

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 relative benefits received or other equitable relationship. Subject to the foregoing, a cost is allocable to a sponsored agreement if (1) it is incurred solely to advance the work under the sponsored agreement; (2) it benefits both the sponsored agreement and other work of the institution, in proportions that can be approximated through use of reasonable methods; or (3) it is necessary to the overall operation of the institution and, in light of the principles provided in this Circular, is deemed to be assignable in part to sponsored projects.

(1) and (2) above applies to allocating direct costs between or among Federal projects. (3) above applies to allocating indirect costs. In addition, OMB Circular A-21, Section C 4 b states the following:

Any costs allocable to a particular sponsored agreement under the standards provided in this Circular may **not** be shifted to other sponsored agreements in order to meet deficiencies caused by **overruns** or other fund considerations, to avoid restrictions imposed by law or by terms of the sponsored agreement, or for other reasons of convenience.

Therefore, when an account is overspent, the overage cannot be moved to another Federal award. In such a case, the overage must be moved to a Non-

Federal account. This requirement reinforces the need for proper grants management throughout the project period to make the best use of the funds.

The following rule from OMB Circular A-21, Section C 4 c, must also be noted:

Any costs allocable to activities sponsored by industry, foreign governments or other sponsors may **not** be shifted to federally-sponsored agreements.

Therefore, any cost that benefits a non-federal project cannot be charged to a federal award. In order to comply with this rule, all costs must be allocated to non-federal projects, both cost reimbursable and fixed price. For example, if the University receives a fixed price award from a non-federal sponsor and no costs are charged to the account, it is clear that the costs incurred to perform the non-federal project are charged to another project, which could potentially be a Federal award. In this case, the Federal project would be supporting the work required to carry out the non-federal project, which is a clear violation of OMB Circular A-21.

To provide further guidance concerning allocating expenses, OMB Circular A-21, Section C 4 d (3), states for the following:

Direct cost allocation principles. 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**. 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, ... the costs may be allocated or transferred to benefited projects on any reasonable basis.

One Federal sponsor provides additional guidance on “interrelated” projects. NIH states the following in the NIH Grants Policy Statement concerning “Closely Related Work”:

Allocation of Costs and Closely Related Work

When salaries and/or other activities are supported by two or more sources, issues arise as to how the direct costs should be allocated among the sources of support. In general, if a cost benefits two or more projects or activities in proportions that can be determined without undue effort or cost, it should be allocated to the projects on the basis of 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, it may be allocated or transferred to the benefited projects on any reasonable basis.

A grantee may allocate costs normally assignable to multiple projects to one of those projects or else to treat multiple projects as a single cost objective regardless of the funding IC (NIH Institute/Center) or whether the awards involve the same or different PIs, if it obtains NIH prior approval for this "closely related work." When multiple ICs are involved, the request for approval should be submitted to the designated GMO of each of the affected ICs. NIH will use the following criteria in reviewing such requests:

- The grants must be scientifically and technically related,

- There must be no change in the scope of the individual grants involved,
- The arrangement must not be detrimental to the effort approved under each individual award, and
- The relatedness must not be used to circumvent the terms and conditions of an individual award.

In addition, recipients of NIH awards under the Federal Demonstration Partnership (FDP) may be permitted, with the approval of NIH and the other funding agency(ies), to treat related projects funded by NIH and another agency(ies) as a single cost objective for purposes of OMB Circular A-21.

2. **Unacceptable Allocation Methods:** Some direct costing practices are not acceptable methods of allocating costs because the cost cannot be identified with a project with a “high degree of accuracy”, a requirement for a direct cost. Following is a list of allocation methods which are NOT acceptable:

- a. Rotation of charges among projects by month (or week or semester or other interval) without establishing that the rotation schedule credibly and accurately reflects the relative benefit to each project.
- b. Assigning charges to a project with the largest remaining balance.
- c. Assigning charges to a project with the earliest end date.
- d. Charging the budgeted amount to the project, as opposed to charging an amount based on actual usage.
- e. Assigning charges to a sponsored project in advance of the time that the actual cost was incurred. For example, prepayments such as travel advances are not allowable cost on Federal awards, as discussed in OMB Circular A-21 Section J. 48:

48. *Travel costs.*

a. *General.* Travel costs are the expenses for transportation, lodging, subsistence, and related items incurred by employees who are in travel status on official business of the institution. Such costs may be charged on an **actual basis**, on a per diem or mileage basis in lieu of actual costs incurred, or on a combination of the two, provided the method used is applied to an entire trip and not to selected days of the trip, results in reasonable charges, and is in accordance with the institution's travel policy and practices consistently applied to all institutional travel activities.

- f. Describing a cost as something other than what it actually is. In other words, we cannot misclassify an unallowable cost in order to disguise it as an allowable cost. For example, office supplies should not be coded as lab supplies. Instead, the CAS 502 Exception Form should be used to request approval to charge office supplies as direct cost on

a Federal award when “special circumstances” exist. If “special circumstances” do not exist for the project, the office supplies are not allowable costs.

There are additional reasons why it is very important to use the proper Banner Account Codes (formerly known as SAMAS object codes) for expense transactions:

- i. Miscoded expenses can result in incorrect F&A cost charged to a project. The Banner Account Code determines whether or not the cost will be included in the F&A base (typically Modified Total Direct Cost) and therefore subject to F&A.
- ii. Failure to identify capital equipment purchases can result in noncompliance with internal and external property management regulations. OMB Circular A-110 requires that all equipment and capital expense purchases be added to the inventory system. The Banner Account Code used on the capital equipment requisition is one method that Property Management uses to identify capital equipment purchases to be added to the University inventory.
- iii. Errors in account coding contribute to misleading reports concerning the financial status of a project.
- g. Charging expenses exclusively to a Federal project, when the expense also benefits other projects or activities. For example, it is not an allowable allocation method to purchase chemicals or lab supplies and charge one Federal project, when the items are used on other sponsored projects or for instruction.
- h. Charging costs to a project that is close to the expiration date of the project in order to “use up the funds” or “spend out the grant”. The project will clearly not benefit from such purchases as the goods will not be received until after the project ends. The project must benefit from the expense and “dumping costs” on a Federal project is a clear violation of OMB Circular A-21.

C. **Consistent Treatment of Costs:** OMB Circular A-21, Section F 6 (b) states the following:

b. The following guidelines apply to the determination of departmental administrative costs as direct or F&A costs.

(1) In developing the departmental administration cost pool, special care should be exercised to ensure that **costs incurred for the same purpose in like circumstances are treated consistently as either direct or F&A costs**. For example, salaries of technical

staff, laboratory supplies (e.g., chemicals), telephone toll charges, animals, animal care costs, computer costs, travel costs, and specialized shop costs shall be treated as direct cost wherever identifiable to a particular cost objective. Direct charging of these costs may be accomplished through specific identification of individual costs to benefiting cost objectives, or through recharge centers or specialized service facilities, as appropriate under the circumstances.

(2) The salaries of administrative and clerical staff should normally be treated as F&A costs. Direct charging of these costs may be appropriate where a major project or activity explicitly budgets for administrative or clerical services and individuals involved can be specifically identified with the project or activity. "Major project" is defined as a project that requires an extensive amount of administrative or clerical support, which is significantly greater than the routine level of such services provided by academic departments. Some examples of major projects are described in Exhibit C.

(3) Items such as office supplies, postage, local telephone costs, and memberships shall normally be treated as F&A costs.

Therefore, all costs incurred for the same purpose, in like circumstances, are either treated as direct costs or indirect costs. This criterion is the essence of Cost Accounting Standard 502, "*Consistency in Allocating Costs Incurred for the Same Purpose by Educational Institutions*". CAS 502 is discussed in Section IV B of this document. FAU has implemented the CAS 502 Exception Form to ensure compliance with CAS 502 and OMB Circular A-21, F 6 b. The CAS 502 Exception Form and Instructions are included in Exhibit D of this document.

The Banner Budget Pools and Account Codes for the Non-Labor Administrative Costs that are typically treated as indirect costs by FAU are listed in Exhibit G. If "special circumstances" exist, then an exception can be made to charge the expense item as a direct cost to the Federal award. In such a case, the PI uses the CAS 502 Exception Form. Examples of the "special circumstances" for Non-Labor Administrative Costs on Federal awards are discussed in Exhibit F.

In the case of Administrative and Clerical Salaries, a Major Project must exist, as required by OMB Circular A-21, Section F 6 b. See Exhibit E of this document for a List of the Major Projects.

- D. **Conforming to any limitations:** costs must be allowable under OMB Circular A-21 and the Terms and Conditions of the award, as well as the University's guidelines.

OMB Circular A-21, C 7 states the following:

Limitations on allowance of costs. Sponsored agreements may be subject to statutory requirements that limit the allowance of costs. When the maximum amount allowable under a limitation is less than the total amount determined in accordance with the

principles in this Circular, the amount not recoverable under a sponsored agreement may **not** be charged to other sponsored agreements.

Therefore, if a Federal sponsor does not allow a certain expense on a project, or limits the amount of cost, the unallowable cost cannot be charged to another Federal project. For example, NIH has a Salary Cap as stated in NIH NOTICE: NOT-OD-03-034, as follows:

For fourteen consecutive years, Congress has legislatively mandated a provision for the limitation of salary. For FY 2003, the Consolidated Appropriations Resolution 2003, Public Law 108-7, which includes appropriations for the Department of Health and Human Services, restricts the amount of **direct salary of an individual under an NIH grant or cooperative agreement** (referred to here as a grant) or applicable contract to Executive Level I of the Federal Executive Pay scale. The Executive Level I annual salary rate was \$166,700 for the period January 1 through December 31, 2002. Effective January 1, 2003, the Executive Level I salary level increased to **\$171,900**.

For the purposes of the salary limitation, the terms "direct salary," "salary," and "institutional base salary" have the same meaning and are exclusive of fringe benefits and facilities and administrative (F&A) expenses, also referred to as indirect costs. An individual's institutional base salary is the annual compensation that the applicant organization pays for an individual's appointment, whether that individual's time is spent on research, teaching, patient care, or other activities. Base salary excludes any income that an individual may be permitted to earn outside of the duties to the applicant organization.

Therefore, if a researcher earns more than the NIH Salary Cap of \$171,900 annually, the amount of salary over the cap cannot be charged to another Federal award or used as cost share.

In addition, OMB Circular A-21, C 12 states:

Costs **expressly unallowable** or mutually agreed to be unallowable, including costs mutually agreed to be **unallowable directly associated costs**, shall be identified and excluded from any billing, claim, application, or proposal applicable to a sponsored agreement.

Therefore, costs considered "unallowable" must be identified and accounted for separately. Unallowable costs must not be included in proposal budgets, charged to FAU Project Accounts or Cost Share Accounts, included in financial reports submitted to Federal sponsors, or included in F&A cost pools used to compute the F&A cost rate. See CAS 505 in Section IV. of this document for more information concerning unallowable costs. Also, Exhibit H of this document includes an Allowability Grid, which lists costs and whether or not they are allowable on a Federal award.

OMB Circular A-21, Section J states:

In case of a discrepancy between the provisions of a specific sponsored agreement and the provisions below (Section J), the agreement should govern.

Therefore, if the Terms and Conditions of a Federal award include more limitations than those stated in OMB Circular A-21, the award Terms and Conditions must be followed in addition to the guidelines in OMB Circular A-21. Therefore, it is extremely important that Principal Investigators and Department Budget Coordinators read the Terms and Conditions of each Federal award that they are responsible for in order to determine if additional cost limitations exist.

Some Federal sponsors mandate specific cost limitations. For example, the NSF Grants Policy Manual limits summer salary as follows:

Periods Outside the Academic Year. During the summer months or other periods not included in the period for which the base salary is paid, salary is to be paid at a monthly rate not in excess of the base salary divided by the number of months in the period for which the base salary is paid. NSF policy on funding of summer salaries (known as **NSF's two-ninths rule**) remains unchanged: proposal budgets submitted should not request, and NSF-approved budgets will not include, funding for an individual investigator which exceeds two-ninths of the academic year salary. This limit includes summer salary received from all NSF-funded grants.

The above limitation must be followed for all proposals submitted to NSF. It is an example of "conforming to any limitations".

Another example of "conforming to limitations" is NSF's Cap on Daily Rates for Consultants. The following is stated in NSF's Grant General Conditions (GC-1):

Consultant Services

Payments to individuals for consultant services under this grant shall not exceed the daily equivalent of the then current maximum rate to an Executive Schedule Level IV Federal employee (exclusive of indirect cost, travel, per diem, clerical salaries, fringe benefits and supplies). The current rate is \$513.00 per day.

All proposals submitted to NSF must conform to this cost limitation. In addition, payments made to consultants on all projects funded by NSF must not exceed this daily rate.

E. **Net of Applicable Credits:** OMB Circular A-21, Section C states:

1. *Composition of total costs.* The cost of a sponsored agreement is comprised of the allowable direct costs incident to its performance, plus the allocable portion of the allowable F&A costs of the institution, **less applicable credits**.

In addition, OMB Circular A-21 Section C 5 a states the following:

5. *Applicable credits.*

a. The term "**applicable credits**" refers to those receipts or negative expenditures that operate to offset or reduce direct or F&A cost items. Typical examples of such transactions are: purchase discounts, rebates, or allowances; recoveries or indemnities on losses; and adjustments of overpayments or erroneous charges. This term also includes "educational discounts" on products or services provided specifically to educational institutions, such as discounts on computer equipment, except where the arrangement is clearly and explicitly identified as a gift by the vendor.

Therefore, credits, such as purchase discounts, rebates, overpayments, or erroneous charges must be applied to the same account that the purchase was originally charged to. In other words, if a credit is received on a prior purchase, the credit cannot be funneled to and accumulated in a different account. The Federal sponsor should not reimburse the University for the amount of the credit.