An Explanation of Indirect Costs

What are Indirect Costs?

Costs involved in conducting sponsored projects are categorized in two ways: direct costs or indirect costs. The federal government refers officially to indirect costs as facilities and administrative (F&A) costs, sometimes simply called "overhead" costs. Direct costs and F&A costs together are the actual cost of a sponsored project.

Direct costs are "those costs that can be identified specifically with a particular sponsored project relatively easily with a high degree of accuracy." For example, the salary of a principal investigator (PI) or the purchase of specific supplies for a specific experiment are direct costs. They must be:

- Allowable (as described by federal cost principles in OMB Circular A-21);
- Reasonable (what a prudent person would spend);
- Allocable (limited to that portion of expenses directly benefiting the project and consistently treated as direct charges).

Indirect costs are "those that are incurred for common or joint objectives." In other words, indirect costs cannot be specifically attributed to an individual project. For example, it is difficult to say how much of a PI's lab space is used for a specific research project when multiple projects are being conducted in the same lab. We know the project benefits from the lab space, but it is impractical to accurately calculate the cost associated with that benefit. Accordingly, F&A costs are estimated for each project using a formula that compares all Institutional project expenditures against all the Institutional facility and administrative costs necessary to support all projects.

How is the F&A Rate Established?

The Institutional F&A costs that are necessary to support the research and service enterprises of the University are compiled and presented to the Department of Health and Human Services (DHHS) in a proposal submitted by the University and audited by DHHS. The University and DHHS then negotiate a percentage to be added to the direct costs of each project that will cover the University’s actual F&A expenditures for all anticipated projects over a specific time period. For these negotiations, the University categorizes all F&A costs as facilities or administrative based on the nature of the cost. Costs for building depreciation, equipment depreciation, libraries, and operation and maintenance are categorized as facilities while costs for general, departmental, legal, compliance, and sponsored project administrations are categorized as administrative.
What Are Some Examples of Institutional Resources Included in F&A Calculations?

Affirmative action monitoring
Animal and human subjects protection
Building maintenance
Custodial services
Deans, department chairs, etc.
Departmental administrative assistants
Equipment
Human resources services
Laboratory space
Legal counsel
Libraries
Office space
Office supplies
Purchasing services
Research accounting
Sponsored programs services
Telecommunications infrastructure
Utilities costs

This list is not exhaustive, but it provides an idea of the range of costs incurred by an institution in the support of research and sponsored programs.

How are F&A Rates Applied?

Part of the University’s agreement with the Federal Government regarding F&A is that the University will not offer a lower F&A rate to other kinds of sponsors. That means that the University has to use the same rates for commercial sponsors as it does for the Federal Government. The University would jeopardize its relationship with the Federal Government (the University’s single largest sponsor) if it were to accept lower rates. Further, when conducting sponsored activity, the University strives to be reimbursed for the full cost of that activity. Unfortunately, even when the current 50.5% F&A rate is added to the direct costs of a research project, a portion of the total costs necessary to support that project may not be recovered by the University because of limitations created by federal allowable cost principles. The University would in effect be subsidizing the actual costs of a sponsored activity when non-standard F&A rates are applied. While some may perceive that F&A is discretionary, the University could not maintain sponsored activity on campus for long without reimbursement for the costs required to support the research and service enterprise. Even at a rate of 50.5% the University ultimately only collects a little less than 50 cents on every dollar spent by the University to support sponsored activity infrastructure.

What Costs Are Reimbursed by F&A Funds?
F&A costs represent a reimbursement for expenses already incurred.

**Why Are F&A Funds Important to You?**

Whatever we call them, indirect costs are real. The University is dependent upon the recovery of F&A costs in order to maintain the infrastructure necessary to support sponsored activities.

Faculty, staff, and students involved in research and sponsored programs experience the benefits of F&A cost recovery every day when they enter a building, turn on the lights, consult with a research assistant, get help from research administration professionals when they write proposals or in managing grants and contracts, or use the telephone, internet or the libraries just to name a few examples.