

ACCOUNTING FOR UNALLOWABLE COSTS

I. REFERENCES AND RELATED POLICIES

- A. [OMB Circular No. A-21, Cost Principles for Educational Institutions](#)
- B. Cost Accounting Standards Board Regulations, Part 9905.505, Accounting for Unallowable Costs – Educational Institutions
- C. [UCSD Cost Accounting Standards Board Disclosure Statement \(CASB DS-2\)](#)
- D. UCSD Policy and Procedure Manual (PPM)
 - [150-14](#) Facilities and Administrative Cost Rates Applicable to Research, Instruction, and Other Federal and Non-Federal Sponsored Projects
 - [150-40](#) Cost Accounting Standards Compliance
 - [150-42](#) Classification of Costs as Direct or Facilities and Administrative (Indirect)
 - [150-45](#) Cost Sharing on Sponsored Projects
 - [300-51](#) Account Code Validation

II. DEFINITIONS

A. Directly Associated Cost

Any cost which is generated solely as a result of the incurrence of another cost, and which would not have been incurred had the other cost not been incurred.

B. Facilities and Administrative (F&A) Costs

Costs that are incurred for common or joint objectives and, therefore, cannot be identified readily and specifically with a particular sponsored project, an instruction activity, or any other institutional activity and cannot be directly charged. A grouping of incurred costs that is identified with two or more cost objectives but not with any final cost objective is referred to as an F&A cost pool. F&A costs are also referred to as “indirect” costs.

C. Unallowable Cost

Any cost which under the provisions of any pertinent law, regulation, or extramural award cannot be included in prices, cost reimbursements, or settlements under a federal award to which it is allocable.

1. “Expressly unallowable costs” are those particular cost types that are specifically named and stated in applicable cost principles to be not chargeable to federally sponsored projects.
2. “Mutually agreed to be unallowable costs” are those costs that the institution and the federal government have agreed will be considered unallowable.
3. “Previously determined to be unallowable costs” are those costs which were previously in dispute and which have been determined to be unallowable by a final

decision of the Contracting Officer or by a ruling of a court, board, or other venue responsible for making such determinations.

4. Unallowable "directly associated costs" are those costs that are incurred solely as a result of incurring an unallowable cost.

III. BACKGROUND/SCOPE

- A. In order for a cost to be considered an allowable direct or indirect charge to a federal award, it must meet certain tests of allowability established by OMB Circular A-21. These tests are summarized as follows:
 1. The cost must be reasonable. A cost is considered reasonable if the nature and the amount involved for goods or services acquired or applied 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.
 2. The cost must be allocable to sponsored agreements under the principles and methods provided in OMB Circular A-21. A cost is considered allocable to a particular cost objective 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:
 - (a) it is incurred solely to advance the work under the sponsored agreement;
 - (b) it benefits both the sponsored agreement and other work of the institution, in proportions that can be approximated through use of reasonable methods, or
 - (c) it is necessary to the overall operation of the institution and is deemed to be assignable in part to sponsored projects.
 3. The cost must be given consistent treatment through application of those generally accepted accounting principles appropriate to the circumstances, and
 4. The cost must conform to any limitations or exclusions set forth in OMB Circular A-21 or in the sponsored agreement as to types or amounts of cost items.
- B. [Cost Accounting Standard 505](#), Accounting for Unallowable Costs, was issued to provide guidance on accounting requirements for the identification and segregation of unallowable costs. CAS 505 pertains to each of the forms of unallowable costs identified in Section II. C. above.
- C. CAS 505 does not govern or define the types of costs to be considered unallowable. Such guidance is provided by OMB Circular A-21. Rather, CAS 505 imposes requirements as to the proper accounting for unallowable costs.

IV. POLICY

- A. All unallowable costs shall be identified and excluded from any billing, claim, or proposal under a federal government award.
- B. Those individuals responsible for submitting proposals, classifying costs, or preparing billings shall be familiar with, and shall comply with, the requirements imposed by CAS 505 and this procedure. Training will be provided to personnel affected by the procedure

and designated individuals shall be made available to provide guidance for proper cost classifications.

- C. The costs of any work project not authorized by a sponsored agreement, whether or not related to performance of a proposed or existing sponsored agreement, shall be accounted for in a manner, which permits ready separation from the costs of authorized work projects.
- D. The costs pertaining to formal cost sharing shall be accounted for in a manner that permits identification to the sponsored project to which it pertains. Refer to PPM 150-45, Cost Sharing on Sponsored Projects, for accounting requirements.
- E. Rate limits or caps imposed by OMB Circular A-21 or by negotiation with the federal government may limit the institution's ability to recover all costs that would otherwise be allocable and allowable. These caps will not be considered in determining the proper classification of administrative costs.

V. PROCEDURES

A. Identification and Segregation of Expressly Unallowable Costs

1. Expressly unallowable costs shall be identified and charged to appropriate accounts at the time they are initially recorded. The UCSD cost account structure provides codings for capturing these costs and proper coding of these costs is critical for complying with the CAS 505 requirements for identification and segregation of expressly unallowable costs.
2. Some activities are unallowable in their entirety, even if the individual cost components incurred in performing that activity are not otherwise expressly unallowable. An example is fund raising, which is an unallowable activity although its typical cost components such as salaries, travel, telecommunications, and postage would not otherwise be unallowable. The costs of such activities shall be accounted for in such a manner as to permit identification and segregation.
3. Because of the need to identify, segregate, and voluntarily exclude unallowable costs, these costs shall be clearly identified in the accounting records and supporting documentation shall be maintained for the amount and type of cost.
4. In some instances the accounting records may not be sufficient to clearly identify an unallowable cost or activity. This could occur when a booked cost is partially unallowable or when an unallowable activity results in the incurrence of several different types of otherwise allowable costs. In this circumstance, supplemental records (such as a spreadsheet) shall be maintained to identify the unallowable cost and to provide an explanation for the cost classification.

B. Determining Cost Allowability

1. Section J of OMB Circular A-21 is the definitive guideline for identifying expressly unallowable costs.
2. The Cost Categorization Matrix provides additional guidance regarding the allowability of many types of costs. This matrix is intended to address common situations encountered at UCSD but cannot anticipate all types of costs that might be incurred or anticipated. Additionally, users of the matrix also need to consider

other allowability factors, such as cost reasonableness, allocability to specific cost objectives, or limitations included in agreement terms.

3. The Office of Post Award Financial Services shall be contacted when there is a question as to whether a particular type of cost should be considered allowable or unallowable, or as to the proper method of recording an unallowable cost.

C. Other Considerations for Determining Whether a Cost is Allowable or Unallowable

1. Costs that would be incurred even without an associated unallowable charge will not normally be treated as an unallowable "directly associated cost." For example, indirect facility costs allocable to an individual who spends a minor amount of time on unallowable activities would not normally be classified as unallowable. However, direct facility costs that are acquired or maintained to support significant levels of unallowable activities would likely be considered directly associated costs of those activities.

Because this can be a complex issue, the Office of Post Award Financial Services shall be consulted if there is any uncertainty as to the proper cost treatment of associated costs.

2. Some costs can be directly associated with the labor costs to which they pertain. In such instances the associated costs will be classified in the same manner as the related labor. Common examples include fringe benefits and travel costs.
3. In some instances a specific cost or activity, or a directly associated cost of an unallowable cost, may become designated as unallowable as a result of a written decision furnished by a federal sponsor pursuant to dispute procedures. These types of costs or activities must be identified and segregated in the same manner as other unallowable costs.

If UCSD should decide to appeal such a decision, additional guidance will be provided to affected organizations so that requirements of CAS 505 are complied with while maintaining the possibility of future cost recovery when the issue is finally settled.

D. Conflicting Sponsor Guidance

1. A sponsoring agency or a sponsored agreement may authorize or direct the treatment of an otherwise unallowable cost as an allowable direct cost for a specific program. This may occur when the inherent purpose of the program requires that such a cost be incurred.

Such costs may be considered allowable costs of that program provided that they satisfy the requirements for a direct cost and there is sufficient documentation to clearly indicate the sponsor's intent to allow the costs.

2. A sponsoring agency or a sponsored agreement may expressly state that certain costs will not be reimbursable although they are not expressly unallowable under OMB Circular A-21. If such costs are incurred in performing the sponsored agreement, they shall be accounted for as unallowable costs and excluded from any billing.
3. Amounts that are not recoverable under a sponsored agreement may not be charged to other sponsored agreements.

4. Costs that are incurred in support of a specific agreement but that are non-reimbursable under terms of the agreement may constitute cost sharing that should be accounted for in accordance with PPM [150-45](#).

E. Treatment of Unallowable Costs for Indirect Rate Development

1. Unless a different treatment is expressly agreed to by the cognizant federal agency, all forms of unallowable F&A costs shall be excluded from indirect cost pools.
2. The process of identifying and excluding unallowable costs from indirect cost pools involves three major steps. These are described in CASB DS-2 and are summarized as follows:
 - a. codings of unallowable costs
 - b. removal of entire unallowable activities
 - c. final screening
3. Unallowable costs are subject to the same cost accounting principles governing cost allocability as allowable costs.

If an unallowable cost would normally be part of an indirect cost allocation base, it shall remain in the base and absorb an allocable share of the indirect costs.

If a directly associated cost is part of a category of costs that would normally be included in a cost pool that is allocated over a base that includes the cost to which it is associated, the directly associated cost shall remain in the cost pool. The process of allocating a portion of the pool to the unallowable base costs will be considered sufficient to meet the requirement for identifying and removing the directly associated cost.

F. Exclusion of Unallowable Costs from Proposals, Billings, and Claims

1. All proposals, billings, and claims submitted to the federal government shall exclude costs that are unallowable. The government's acceptance of a proposal, bill, or claim that includes unallowable costs neither commits the government to paying for those costs nor changes the cost's character from unallowable to allowable.
2. Should such unallowable costs be included and paid by the federal government, the institution may later be required to reimburse the costs plus possible interest and penalties. The institution could also be deemed to be in non-compliance with CAS requirements that may lead to the requirement for cost impact studies.

VI. RESPONSIBILITIES

A. Principal Investigator/Department

Responsible for developing proposals requesting extramural support and for assuring that all direct costs proposed and incurred comply with the requirements of this policy and meet the federal and University criteria for proposing and charging of direct costs.

B. Office of Contract and Grant Administration (OCGA)

Responsible for all direct versus F&A cost issues and inquiries related to proposal development and pre-award activities, and for negotiation of project terms and conditions.

C. Financial Analysis Office

Responsible for all direct versus F&A cost issues relating to campus recharge activities, and to the development and negotiation of F&A cost rates.

D. Office of Post Award Financial Services (OPAFS)

Responsible for all direct versus F&A cost issues relating to project accounting, financial reporting, effort certification, and other post-award aspects.

E. CAS Compliance Officer

The CAS Compliance Officer for UCSD is the Director of the Office of Post Award Financial Services (OPAFS). The Director has operational authority and responsibility to ensure that UCSD maintains a reasonable level of compliance with CAS requirements.

F. Audit & Management Advisory Services

Responsible for conducting a recurring program of audits to evaluate business processes and activities, and the adequacy of departmental and division internal controls to provide reasonable assurance of compliance with appropriate federal and state regulations, and University policies and procedures.

G. Office of the Controller

Overall responsibility for direct versus F&A compliance and cost implementation.