This procedure outlines New Mexico Institute of Mining and Technology’s (NMIMT) responsibilities for accounting for federally defined allowable and unallowable costs for overhead reimbursement purposes. In addition, the procedure facilitates training of individuals involved in the coding of financial transactions, in order that they become familiar with governing regulations to ensure the proper classification of expenditures that are included in the indirect cost (overhead) rate.

This is a working document and as such, we would appreciate any information and/or insight which would help us develop stronger policies for NMIMT's research community.
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I. Introduction

This procedure outlines New Mexico Institute of Mining and Technology’s (NMIMT) responsibilities for accounting for federally defined allowable and unallowable costs for overhead reimbursement purposes. In addition, the procedure facilitates training of individuals involved in the coding of financial transactions, in order that they become familiar with governing regulations to ensure the proper classification of expenditures that are included in the indirect cost (overhead) rate.

Office of Management and Budget (OMB) Circular A-21 establishes principles for determining costs applicable to grants, contracts, and other agreements with educational institutions. OMB Circular A-21 also provides guidelines used in preparing an overhead rate submission. In addition, it defines what is allowable and unallowable indirect costs for federal reimbursement purposes.
II. Definitions

A. Allowability
Allowability is used for reimbursement purposes and pertains to direct and indirect charges. According to OMB A-21 Section C.2, allowable costs must be:

- **Reasonable** – The nature of goods or services acquired or applied and the amount involved 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.
- **Allocable** – The process of assigning a cost or group of costs to one or more cost objectives in proportion to the benefit or other equitable relationship provided.
- **Consistently Treated** - Like expenses must be treated the same in like circumstances.
- **Allowable** - Expense must be allowable or not specifically excluded as specified by government regulations.

B. Cost Allocability
The allocability of cost involves an assessment of the relative benefits received from the incurrence of the cost. The National Association of College and University Business Officers (NACUBO) lists three different levels of cost allocability, which are as follows:

1. Cost is incurred solely to advance work under the sponsored agreement.
2. Expense is incurred in a manner that benefits both the sponsored agreement and other work of the institution in proportions than can be approximated through the use of reasonable methods.
3. Cost is necessary for the overall operation of the institution and under Circular A-21, and deemed to be assignable in part to sponsored projects.

C. Defense Contract Audit Agency (DCAA)
The Defense Contract Audit Agency (DCAA) is a federal agency which audits NMIMT’s overhead proposals on behalf of the Office of Naval Research (ONR).

D. Direct Costs
Direct costs are defined as costs that can be identified specifically with a particular sponsored project or NMIMT activity. These costs can be assigned to such activity relatively easily and with a high degree of accuracy. Identification with the sponsored work rather than the nature of the goods and services involved is the determining factor in distinguishing direct from indirect costs of sponsored agreements (OMB A-21 Section D.2).
E. Indirect Costs
Indirect costs are defined as costs that are incurred for common or joint objectives and therefore cannot be identified with a particular sponsored project, an instructional activity or any other institutional activity (OMB A-21 Section E.1). Indirect costs may also be referred to as Facilities and Administrative (F&A) costs.

F. Office of Naval Research (ONR)
The Office of Naval Research (ONR) is NMIMT’s cognizant federal agency. The ONR has responsibility for approving or disapproving NMIMT’s proposed overhead rates.
## III. General Information

The federal government provides direct support for federally sponsored agreements and reimburses NMIMT for its share of NMIMT’s general operating costs (e.g., indirect costs). The government provides for the allocation of a portion of these operating costs to grants and contracts through approved indirect cost rates. Indirect cost rates are calculated and approved on an annual basis. DCAA audits both the study and proposal. The rates provided are then negotiated with the ONR.

The calculation process involves a comparison of total allocable indirect costs to modified total direct costs of a particular function. The resulting ratio is referred to as the “indirect cost rate.” Indirect cost rates are calculated for the organized research function and other sponsored activities of NMIMT.

As part of this allocation process, indirect costs are segregated into the following indirect cost pools:

- **Building Usage Allowance** – compensation to NMIMT for use of buildings (*OMB A-21 Sections F.2 and J.14*).
- **Equipment Usage Allowance** – compensation to NMIMT for use of equipment (*OMB A-21 Sections F.2 and J.14*).
- **Departmental Administration** – administrative and supporting services pertaining to department objectives. This includes the general activities performed in academic departments to support instruction and research. (*Cost Category 40 and OMB A-21 Section F.6*).
- **General Administration and Expenses** – represents central and general executive and administrative activities of NMIMT (*Cost Category 50 and OMB A-21 Section F.5*).
- **Sponsored Projects Administration** – departments established primarily to administer sponsored projects (*Cost Category 60 and OMB A-21 Section F.7*).
- **Operations and Maintenance** – activities that have been incurred by a central service organization for the operation and maintenance of the infrastructure (*Cost Category 80 and OMB A-21 Section F.4*).
- **Library** – activities that directly support the operation of the library (*Cost Category 70 and OMB A-21 Section F.8*).
The activities in the accounts assigned to these pools must be consistent with OMB A-21’s definition of the function and must not include expressly unallowable costs outlined under OMB A-21 Section J.

NMIMT is legally required to submit a certification with each indirect cost rate proposal attesting to the fact that no unallowable expenses are included in the indirect cost rate proposal. Sanctions for noncompliance include non-recovery of indirect costs and penalties of perjury for false certification. Federal regulations stipulate that all indirect costs deemed unallowed by the government are subject to a penalty equal to the amount of the disallowed expense plus interest.
### IV. Treatment of Unallowable Costs

The term unallowable cost does not mean that the charge is unlawful, improper, or even wrong. In the context of cost recovery as defined in OMB Circular A-21, it means that the federal government will not participate either directly or indirectly in the cost.

For F&A preparation purposes, NMIMT handles unallowable costs (for federal reimbursement purposes) in the following manner:

A. In each allocation base: Unallowable costs are not removed from the MTDC base of Instruction, Research or Other Institute Activities (OIA) and hence receive a full allocation of indirect costs.

B. In each indirect expense pool: Unallowable costs are removed before the allocation to cost objectives. Costs coded as unallowable are transferred to Other Institute Activities which then becomes part of the OIA base/denominator and accordingly the unallowable costs bear their share of F&A.

C. Service Centers: Unallowable costs are removed from service center costs when developing rates are charged to discretionary funds some of which is generated from the difference between direct cost recovery and market rates charged to External Users. The discretionary FUNDS are coded as part of the OIA allocation base and accordingly the unallowable costs bear their share of F&A. For more detail on the subject see the Service Center Procedure Manual.
V. Guidelines

A. Determining Allowable Costs

OMB Circular A-21’s tests of expenditure allowability states that costs must be:

- **Reasonable** – A prudent person would have purchased this item and paid this price.
- **Allocable** – The process of assigning a cost or group of costs to one or more cost objectives in proportion to benefit provided or other equitable relationship.
- **Consistently Treated** – Like expenses must be treated the same in like circumstances.
- **Allowable** – The expense must be allowable or not specifically excluded as specified by government regulations.

Note: If an expense cannot meet the above criteria, it is not eligible for inclusion in the indirect cost rate study regardless of its purpose.

Agencies that sponsor grants and contracts use the term allowable to mean “permitted as a direct cost under the terms of a specific grant or contract.” Expenses that are generally allowable for federal reimbursement may not necessarily be permitted under the terms of a specific grant or contract. Review the terms of the agreement in order to determine the appropriateness of charge.

B. Defining Unallowable Costs

Costs are specifically unallowable under two general conditions:

1. The costs are for an unallowable activity (something you do and record using an account).
2. The costs are for an unallowable expenditure (something you buy, a line item recorded at the object code level).

NMIMT tracks whether activities are allowable for reimbursement through the FUND number to which transactions are charged and tracks allowable and unallowable transactions at the expenditure Account code level. Therefore, it is imperative to understand the definition of the cost category that has been assigned to the Fund number(s) used.

If you find yourself engaged in activities that deviate from the intended purposes of your FUND, you must bring it to the attention of either the Senior Cost Accountant, Indirect Cost Analyst, or Director of Sponsored Projects.

If you are incurring an unallowable expense in an otherwise allowable FUND, you must code the transaction with an Account code 730000 or higher.
VI. Federally Defined Unallowable Activities

Unallowable Activities are generally recorded in separate FUNDs specifically designated for these purposes. Allowable Account codes may be used with these FUNDs since the FUND is not incorporated into the overhead study for reimbursement purposes. These activities may be appropriate and permissible NMIMT type functions; however, the federal government will not reimburse NMIMT for these costs.

Circular A-21 Section J describes fifty-four selected types of cost items, some of which are unallowable for overhead reimbursement purposes. In reviewing costs in each of these areas, please keep in mind that the federal government identifies "associated costs" with unallowable costs. In case of a conflict between OMB A-21 provisions and the provisions of a specific agreement, the terms of the specific agreement govern.

Note: The following list is not meant to be all-inclusive.

A. General Public Relations

General Public Relations include community relations and activities dedicated to maintaining the image of the institution or promoting understanding and favorable relations with the community (OMB A-21 Section J.1).

The only allowable public relations costs are:

- Costs specifically required by sponsored agreements.
- Costs of communicating with the public and press pertaining to specific activities or accomplishments which result from performance of sponsored agreements.
- Costs of conducting general liaison with news media and government public relations officers, to the extent that such activities are limited to communication and liaison necessary to keep the public informed on matters of public concern (e.g., notices of contract/grant awards, financial matters, etc.).

B. Alumni Activities

Costs incurred for, or in support of, alumni and similar activities are unallowable (OMB A-21 Section J.4).

C. Defense and Prosecution in Court

Defense and prosecution of criminal proceedings, civil proceedings, claims, appeals, and patent infringement are considered unallowable (OMB A-21 Section J.13).
D. Housing and Personal Living Expenses
Costs of housing, (e.g., depreciation, maintenance, utilities, furnishings, rent, etc.), housing allowances, and personal living expenses for the institution’s officers are unallowable regardless of whether the cost is reported as taxable income to the employees (OMB A-21 Section J.23).

E. Organized Fundraising
Costs of organized fundraising including financial campaigns, endowment drives, solicitation of gifts and bequests, and similar expenses incurred solely to raise capital or obtain contributions are unallowable (OMB A-21 Section J.20.a).

F. Investment Management Costs
Costs of investment counsel/staff and similar expenses incurred solely to enhance income from investments are unallowable (OMB A-21 Section J.20.b).

G. Lobbying
Attempts to influence the outcomes of any federal, state or local election, referendum, initiative, or similar procedure through monetary contributions, endorsements, publicity or similar activity are unallowable. (OMB A-21 Section J.28.a.1).

H. Selling and Marketing
OMB A-21 Section J.46 states that costs of selling and/or marketing any products or services of the institution (unless allowed under OMB A-21 Sections J.1 and J.38) are unallowable. This activity differs from bid and proposal development costs (OMB A-21 Section J.38) in that marketing is defined as the unsolicited promotion of NMIMT. Bid and proposal work is when an outside entity contacts you to develop a proposal.

I. Student Activity Costs
Costs incurred for intramural activities, student publications, student clubs, and other student activities are unallowable, unless specifically provided for in the sponsored agreements (OMB A-21 Section J.48).
VII. Federally Defined Unallowable Expenditures

In addition to unallowable activities, certain costs are always unallowable, regardless of the activity they support. These costs are unallowable by object and are typically recorded in general ledger expense object codes designed to segregate these costs from allowable costs.

- **Advertising and Public Relation** – Costs designed solely to promote the institution (*OMB A-21 Section J.1.f.4)*.
- **Alcoholic Beverages** – (*OMB A-21 Section J.3)*.
- **Certain Recruitment Costs** – Costs such as color advertising (*OMB A-21 Section J.42.b)*.
- **Certain Travel Costs** – Costs such as first-class travel (*OMB A-21 Section J.53.c)*.
- **Entertainment** – (*OMB A-21 Section J.71)*.
- **Fines and Penalties** – (*OMB A-21 Section J.19)*.
- **Goods and Services for Employee’s Personal Use** – (*OMB A-21 Section J.22)*.
- **Losses on Other Sponsored Agreements** – (*OMB A-21 Section J.29)*.
- **Memberships in Civic, Community, or Social Organizations** – Includes dining and country clubs (*OMB A-21 Section J.33)*.
- **Memorabilia and Promotional Materials** – (*OMB A-21 Section J.1.f.3)*.
- **Moving Costs** – Only applies if employee resigns within twelve months of employment (*OMB A-21 Section J.42.d)*.

In many cases, determining the allowability or unallowability of a particular cost is complex. When in doubt, consult with the Director of Finance, the Assistant Controller of Restricted Funds, or the Indirect Cost Analyst.
VIII. Policy Authorities

The policy authorities are the Director of Finance and the Vice President of Administration and Finance.
IX. References

Cost Accounting Standard (CAS) 9905-505, "Accounting for Unallowable Costs - Educational Institutions."


Office of Management and Budget (OMB) Circular A-21, "Principles for Determining Costs Applicable to Grants, Contracts, and Other Agreements with Educational Institutions."

Office of Management And Budget (OMB) Circular A-110, "Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals and Other Non-Profit Organizations."
X. Flowchart

Is the expense legal?

NO

Do NOT incur the expense under any circumstance.

YES

Is it permissible at NMIMT?

NO

Do NOT incur the expense. Use your own personal funding.

YES

Is it for an allowable activity?

NO

Charge to an account established for unallowable expenditures

YES

Is it for an allowable expense?

NO

Charge to an unallowable Object code.

YES

Is it for a sponsored project?

NO

Charge to a nonsponsored fund.

YES

Is it permissible by the sponsor?

NO

Charge to a sponsored project account.

YES