

## ***INDIRECT COSTS – WHAT DO YOU MEAN?***

Terms such as “indirect cost” are used on a daily basis, but unfortunately there can be more than one meaning. The technical definition of “indirect cost” often bears little relation to the funding provided by sponsors under this heading.

Technically there are only two types of cost, direct and indirect.

**“Direct cost”** is defined in the JCPSG standard definitions for Costing & Pricing as “expenditure which can be economically identified with and specifically measured in respect to a relevant cost object”. This is readily comprehensible as the identifiable cost arising as a direct result of undertaking a particular activity, e.g. in order to carry out a piece of research the department concerned may need to i) appoint a person to undertake the work, ii) require an existing specialist academic member of staff to direct the work, iii) purchase specialist equipment, consumables, etc. and iv) estimate running costs. These costs are “direct” by technical definition.

**“Indirect cost”** is defined in the same document as “expenditure on labour, materials or services which cannot be economically identified with a specific saleable cost unit”. These costs are incurred in simply providing a university infrastructure that can support research, such as departmental staff, general equipment, space, etc. The costs are typically charged to a central code and, being invisible to the individual research budget holder, are often mistakenly regarded as notional.

Unfortunately, although the technical definitions of direct and indirect are fairly simple, sponsors tend to have a different approach and thus have a different meaning for direct and indirect costs.

Many sponsors are willing to fund only **additional or marginal direct costs** i.e. only those costs that would not have been incurred had the activity not taken place, e.g. the purchase of consumables. Some will only fund certain categories of additional direct cost whilst others are willing to meet all. Certain sponsors will also make a contribution towards indirect costs. From the example above, the existing academic member of staff may not be an eligible cost to be supported by the sponsor. A considerable number of sponsors do not meet the full additional direct costs and have indicated that the indirect cost budget line is their contribution towards all costs (direct and indirect) that are not met in full.

The impact of sponsor definition on cost recovery can be seen if we go back to the earlier example of the new research project where there is to be an additional member of staff. The following additional direct costs will be incurred, but may not be funded by the sponsor:

- Recruitment & Selection – advert, interview panel application review time, interview panel interview time, interview expenses.
- Desk and chair
- PC
- Stationery
- Office space
- Lab space
- Equipment storage / utilisation space
- Heat (for office and lab)
- Light (for office and lab)
- Power (for specialist equipment)
- Telephone calls
- Data port activation

All of these costs can be economically identified and attributed to the activity (i.e. are direct costs), but are regarded by a significant number of sponsors as indirect as they are general, part of the environment, rather than specialist in nature.

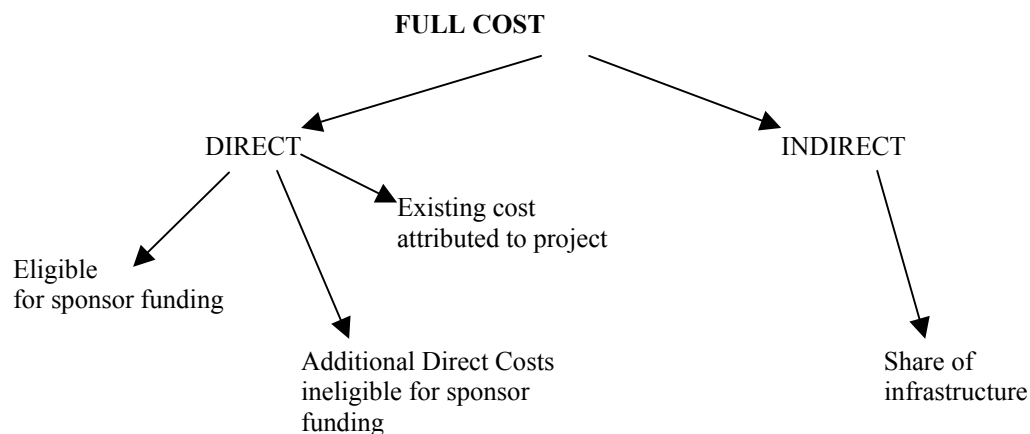
General infrastructure costs of an organisation which, on a full cost basis, should be borne by all activities, but which cannot be said to directly relate to any specific one are true indirect costs, and include:

Grounds maintenance  
Court  
Libraries  
Sports facilities  
Computing Services

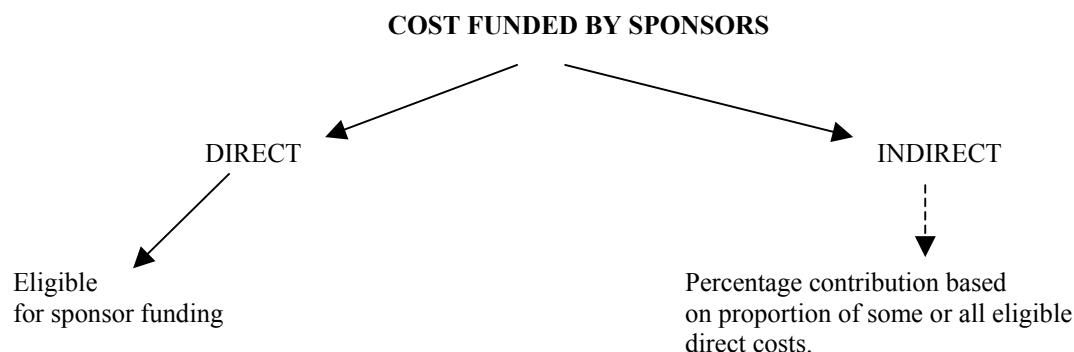
Central Administration (Finance Office, Human Resources etc)  
Repairs & Maintenance  
Senate  
Insurance  
Student Services

The allocation of these general infrastructure costs to activities would be related to the nature of the cost. This ensures that costs related to Teaching and Research are allocated to both, whilst Research related cost are allocated only to Research.

Figure 1 shows full cost and Figure 2 shows what elements of full cost tend to be funded by sponsors and highlight the vast difference between what is incurred and what is funded.



(Figure 1 – Full Cost Breakdown)



(Figure 2 – Sponsor Funding Breakdown)

Example 1 below shows the financial impact of the difference between full cost and funded cost for a Research Council funded project.

*Example 1.*

Full Cost	=	DIRECT eligible,	RAIA £29k, Equipment £20k,	
			Consumables £7k	= £56k
	+	Existing cost attrib. to project	Academic time allocated £8k,	= £8k
	+	Additional DIRECT ineligible,	Desk, Chair & storage £4k, PC £1.5k,	
			Stationery £1k, small items of lab	
			equipment £3k, all space £4k, heat,	
			light and power £2k, Telephone & data	
			ports £0.5k	= £16k
	+	INDIRECT share of infrastructure costs		= £27k

**Full Cost = £107k**

**Research Council Grant funding = £69.3k** (£56k for eligible direct and £13.3k, being 46% of RAIA salary as contribution to indirect)

**Balance to be met by University funds = £37.7k** (unfunded direct £24k, unfunded indirect £13.7k)

Despite the sponsor paying the full amount applied for, the project is under-funded by some 35%. Under the Dual Support system (see Article 1 of this series, published in the December Newsletter), this cost falls on the SHEFC Research Grant.

In summary, the figures utilised are not exact, but are based on real data. The example has been produced on the basis that the sponsor pays a contribution to indirect costs, but many, such as Charities, pay nothing so the extent of under-funding is often worse in reality than in this example.

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