In this tutorial we will address the question of cost acceptability. There are two categories of acceptability: the first is allowability, while the second is eligibility. Allowability is based on what the Federal Acquisition Regulation (FAR) says, adjusted by an agency’s supplemental policies, rules or regulations. Eligibility is defined here as limits imposed by individual agencies on SBIR/STTR awards, or on Phase I (vs. Phase II) awards.

**ALLOWABILITY**

Allowability is discussed in FAR 31.205.1-52, where the Federal government lays out the acceptability of dozens of different types of cost. The allowability of a given cost is either “generally allowable,” “allowable with limitations” or “generally unallowable.” Generally allowable costs are things like manufacturing and production engineering costs and service & warranty costs. The “allowable with limitations” costs range from labor to rent to travel costs, and often are limited to “reasonable” amounts. The “generally unallowable” costs include charitable contributions and alcoholic beverages. Unfortunately, the FAR does not list and discuss all of the costs under each of these three groupings, but instead lumps all three together in an alphabetical list of dozens of cost categories, describing the allowability (and limits thereon) of each.

Salaries and wages of your employees are allowed by the FAR and all SBIR/STTR agencies, so your cost proposal should show a reasonable number of hours and compensation for each person who is contributing to the R&D. Be prepared to defend your labor rates as being “reasonable,” which may be documented with salary surveys from your professional association (or from your informal inquiries to companies employing similar personnel), or from websites like the Bureau of Labor Statistics or salary.com.

**SUPPLEMENTAL REGULATIONS**

In addition to the FAR, you will need to consult the supplemental regulations that most of the SBIR/STTR awarding agencies have. The Department of Defense (DOD), for example, has the DFARS, and the Department of Energy (DOE) has the Department of Energy Acquisition Regulations (DEAR). National Science Foundation (NSF) uses its Proposal & Award Policies & Procedures Guide, and the National Institutes of Health (NIH) has the NIH Grants Policy Statement. Within these supplements, or because of Legislative or Administrative action, various agencies will put additional limits on allowability of particular costs. For example, both NSF and NIH have determined that independent research & development (IR&D) is unallowable, even though most of the other agencies...
with SBIR/STTR programs allow it. Another example is the limit NIH puts on the maximum salary rate that you can charge the agency. Sometimes an agency uses its supplements to provide greater allowability than the FAR provides; for example, DOE allows an applicant to request up to $15,000 in a Phase II SBIR/STTR project for domestic patenting costs, whereas the FAR says that these costs are generally unallowable unless required by your contract or grant.

So that’s what “allowability” is all about. What does “eligibility” refer to, when it comes to costs on an SBIR/STTR project?

**ELIGIBILITY**

As defined here, eligibility refers to those costs that agencies have limited or highlighted, not necessarily because of the FAR or supplemental regulations, but apparently because they want to shape the direction of their SBIR/STTR programs. For example, some agencies will not allow you to purchase equipment, as a direct cost, in your Phase I project. Others agencies prohibit travel in Phase I, while others strongly encourage it and even others require it. Additional examples:

- NIH limits your Phase I indirect (F&A) rate to 40% (as a percentage of all direct costs), unless you have an approved rate on a recent Federal project.
- NSF limits the combination of your indirect and fringe benefits cost to not more than 150% of the direct labor on your NSF SBIR/STTR project.
- All of the agencies allow you a profit/fee on your SBIR/STTR project, and most mention the amount as 7% (as a percentage of your total direct and indirect costs). But some say you can’t exceed 7% while others say “normally” you would not exceed it and others may say it is “an average” of 7%.
- FAR 31.205-7 addresses the concept of a “contingency” to cover unexpected costs. It is allowed, but with limitations. It generally is not allowed in situations in which you have a cost reimbursement award (typical of a Phase II award), because such contracts/grants allow you to bill the actual cost of doing the work, including unexpected ones. And in Phase I, even though most awards are fixed price, we would say contingency is almost always an ineligible cost and therefore should not be included in your cost proposal. Therefore, make sure you have not underestimated the costs of doing the technically risky Phase I R&D.
- None of the agencies treat your routine furniture and equipment as eligible direct costs in your SBIR/STTR project. However, these costs can be covered out of depreciation expense, which is allowable with limitations per FAR 31.205-11. Their initial purchase can be covered by fee/profit, which you can use for anything.

The eligibility of various costs is generally easier to find, as they usually are mentioned in the agency’s SBIR/STTR solicitation. The allowability of costs is trickier—those unique to an agency are more likely mentioned explicitly in the solicitation, while the general, FAR-specified ones may not be. It is recommended that you familiarize yourself with FAR 31.205, clauses 1 through 52, so that you will have a handle on these Federal government wide allowability cost categories.