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Federal Funding Agency Limitations on Cost Reimbursement

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Federal Funding Agency Limitations on Cost Reimbursement: A Request for Consistency in the Application of Federal Guidelines

INTRODUCTION

The Council on Governmental Relations (COGR) is an association of 184 research universities and affiliated academic medical centers and research institutes, which together account for over 90 percent of the federally-funded basic research conducted by Research Universities and institutions. COGR concerns itself with the influence of federal regulations, policies and practices on the performance of research and other sponsored activities carried out at COGR member institutions.

The Federal Cost Reimbursement Perspectives Series comprises several policy discussions that address issues relevant to Federal cost reimbursement policy, including the reimbursement of facilities and administrative (F&A, or commonly referred to as indirect) costs. As appropriate, the discussions advocate for either a revision or a more rational implementation of Federal cost reimbursement policies and practices applicable to financial research administration.

This paper, *Federal Funding Agency Limitations on Cost Reimbursement: A Request for Consistency in the Application of Federal Guidelines*, identifies financial reimbursement policies imposed by Federal funding agencies that are inconsistent with official federal guidelines and result in the significant under-recovery of federal funds by Research Universities and Institutions. The APPENDIX to this paper includes examples of Federal agencies and/or programs where arbitrary agency policy results in additional financial burden for research institutions. While the list is not designed to be comprehensive, it does demonstrate a broad, representative sample of arbitrary agency policies.

RESEARCH EXCELLENCE AND FINANCIAL STABILITY GO HAND-IN-HAND

The appropriate balance between Federal funding and Institutional funding of the research enterprise should be determined through a shared understanding of the importance of institutional financial stability between the Federal government, Faculty and investigators, University administration, and other research enterprise stakeholders. While this discussion raises the issue of what constitutes the equitable level of cost reimbursement to research institutions, what should not be open to discussion is the fact that research excellence and productivity of faculty and investigators is enhanced when an institution is financially stable. When not financially stable, the institution's research mission, as well as the mission of educating students, suffers. Financial instability manifests itself in the form of duress on the general operating budget, which consequently hinders the research mission, both in the short- and long-terms. This includes deferred maintenance on research facilities, inadequate research equipment and tools, and a lack of administrative and compliance support, forcing faculty to carry out these tasks – all of which may lead to a disincentive for the institution to be engaged in sponsored research programs.

The economic crisis in the United States, beginning in 2008, has non-discriminately decimated finances for public and private, small and large higher education institutions, alike. While some institutions have the good fortune of significant endowments, the myth is that research universities are endlessly wealthy institutions. In fact, most research institutions do not have significant endowments. Even an institution with a significant endowment will often be restricted by the donor as to specific uses for the funds – for example, student aid, construction of buildings, or other targeted objectives. The extent to which endowment funds legally can be used to fund the institution's general operating budget is severely limited at most universities.

A research university's general operating budget is supported by unrestricted funds such as state appropriations, student tuition, and F&A reimbursement for prior research-related expenditures and investments. State appropriations are a shrinking pool of funds and student tuition is a limited resource that does not approach covering the full cost of educating a student. F&A reimbursement, while not covering the full cost of maintaining an institution's research infrastructure, must be a reliable financial resource in order to maintain research excellence. It is in the interest of all research enterprise stakeholders to promote a financial reimbursement model that does not put the research infrastructure of our nation's Research Universities and institutions at risk.

THE CONCERN: ARBITRARY AGENCY LIMITATIONS ON COST REIMBURSEMENT

Research institutions are willing and enthusiastic contributors to the research enterprise. In fact, research institutions normally do not look at their financial contribution to research as a subsidy – the financial contributions are essential investments to the educational and research mission. As COGR wrote in its March 2008 paper, *Finances of Research Universities*:

- 1) Senior management and Boards of Trustees understand that an up-front financial commitment must be made by the institution to build state-of-the-art research laboratories and facilities. The commitment is made knowing that future F&A recovery will not fully cover the cost of operating the new buildings.
- 2) Faculty and scientists who do the actual research contribute a significant amount of time to their research endeavors, a portion of which is never charged to the Federal government. This results in a voluntary contribution of research effort, fully paid for by the institution.
- 3) University funded research centers and institutes, availability of start-up funds for new researchers, and internal-competitive awards made from institutional funds has been, and will continue to be, a significant component of the university research mission.
- 4) Cost Sharing commitments, in the form of salaries, equipment, graduate student tuition, and other important items, will continue to be contributed by institutions.
- 5) Research administrators diligently work to ensure institutional compliance with an increasingly complex regulatory environment, without the benefit of additional F&A recovery (as restricted by the 26-percent administrative cap) to fund these compliance requirements.

However, the institutional financial contribution is construed as a subsidy when Federal funding agencies ignore official federal guidelines and impose arbitrary F&A reimbursement limitations and other cost sharing burdens on research institutions.

In September 2010, the Government Accountability Office (GAO) released a report entitled, *University Research: Policies for the Reimbursement of Indirect Costs Need to be Updated* (GAO-10-937). While the GAO did not look at issues specific to arbitrary agency limitations, they did look at topics specific to the F&A reimbursement process. For example, as it relates to the Office of Management and Budget (OMB)

mandated 26-percent limitation on the administrative component of the F&A rate, the GAO recommended that the Director of OMB: *“Reexamine and determine whether reimbursing administrative costs at a maximum rate of 26 percent achieves the appropriate level of cost control and achieves the government’s objective that the federal government bears its fair share of total costs.”* While COGR does not focus on the cost impact of the 26-percent limitation in this paper, the GAO report is significant in its identification of the importance of the “fair share” discussion.

Results of the 2009 *National Science Foundation (NSF) Survey of Research and Development Expenditures at Universities and Colleges* were released in September 2010 (NSF 10-329). The annual NSF survey accumulates data on research and development (R&D) expenditures by source of funds: Federal government, State and local government, Industry, Institutional funds, and Other. The 2009 results showed that for all institutions surveyed, total R&D expenditures were \$54.9 billion – the top two sources being Federal (\$32.6 billion) and Institutional (\$11.2 billion). The survey report described the following: *“The second largest source of funding, institutions’ own funds (internal funds), increased by 7.6% in FY 2009 ... This amount includes separately budgeted organized research funded solely by the institutions (\$6.3 billion) and almost \$5 billion in unrecovered indirect costs related to sponsored research and direct cost sharing.”*

COGR’s March 2008 paper, *Finances of Research Universities*, addressed the topic of the institutional F&A burden applicable to unreimbursed F&A costs. The 2000 RAND Institute study, *Paying for University Research Facilities and Administration*, was informative to the COGR paper. The RAND study found, using data from the 1997 NSF Survey on R&D Expenditures, that: *“Because universities report a total level of support for research from their own funds of about \$5 billion, it appears that these facilities and administration costs represent about one-fifth of the university funds devoted to research (page xii).”* Using the 2009 NSF survey results (\$11.2 billion of university funds devoted to research) and the RAND “one-fifth” benchmark, COGR suggests that the university expenditures for F&A costs not reimbursed by Federal agencies due to arbitrary agency limitations may now exceed \$2 billion.

\$2 billion in F&A costs not reimbursed by Federal agencies is an extraordinary amount. Furthermore, this does not account for direct cost sharing (nor the corresponding F&A associated with direct cost sharing) contributed by research institutions. While some of the unrecovered F&A costs can be attributed to statutory limitations on indirect costs, as well as selected cases where institutions voluntarily waive F&A recovery, a significant portion represents arbitrary agency limitations on F&A reimbursement. Also note, the \$2 billion figure does not include the impact of two other variables: 1) the 26-percent administrative cap, and 2) the federal negotiation model that prevents an institution from establishing its proposed F&A rate. COGR conservatively estimates the impact of these two variables may contribute at least \$1 billion in additional under-recovery.

The APPENDIX to this paper includes examples of Federal agencies and/or programs where arbitrary agency policy contributes to the financial burden being assumed by research institutions.

FEDERAL GUIDELINES SHOULD BE FOLLOWED BY FUNDING AGENCIES

There are two notable Office of Management and Budget (OMB) documents that govern reimbursement of F&A and the related treatment of cost sharing:

- 1) OMB Circular A-21. The Code of Federal Regulations (CFR, Title 2: Grants and Agreements, Part 220) formally codifies OMB Circular A-21. Part 220 is entitled *Cost Principles for Educational Institutions* and consists of the regulations governing the determination of costs associated with

federal grants, contracts and other agreements with Higher Education institutions. Note, OMB Circular A-122 (Cost Principles for Non-Profit Organizations) and OASC-3 (Cost Principles for Hospitals) include guidance similar to Circular A-21, and both are relevant to the discussions that follow.

- 2) OMB Policy Directive on Financial Assistance Program Announcements, June 23, 2003 (Federal Register, Vol. 68, No. 120, pp. 37370-37379). OMB released this directive “... *to establish a standard format for Federal agency announcements of funding opportunities ... The purpose of the standard format is to have information organized in a consistent way in announcements for the hundreds of Federal programs that make financial assistance awards.*” Guidance to agencies on how they are to consider cost sharing is of particular importance in the 2003 OMB Policy Directive.

Below we cite several passages from Circular A-21 and the 2003 OMB Policy Directive (*italics are used for emphasis*).

Circular A-21 – Introductory memo to the Heads of Executive Departments and Establishments and Section G.11.b:

A. Purpose. This Circular establishes principles for determining costs applicable to grants, contracts, and other agreements with educational institutions. The principles deal with the subject of cost determination, and make no attempt to identify the circumstances or dictate the extent of agency and institutional participation in the financing of a particular project. *The principles are designed to provide that the Federal Government bear its fair share of total costs, determined in accordance with generally accepted accounting principles, except where restricted or prohibited by law. Agencies are not expected to place additional restrictions on individual items of cost.* Provision for profit or other increment above cost is outside the scope of this Circular.

G.11.b. Acceptance of rates. *The negotiated rates shall be accepted by all Federal agencies.* Only under special circumstances, when required by law or regulation, may an agency use a rate different from the negotiated rate for a class of sponsored agreements or a single sponsored agreement.

OMB Policy Directive on Financial Assistance Program Announcements, June 23, 2003 (Federal Register, Vol. 68, No. 120, p. 37378).

If an applicant's proposed cost sharing will be considered in the review process (as opposed to being an eligibility criterion described in Section III.2), *the announcement must specifically address how it will be considered* (e.g., to assign a certain number of additional points to applicants who offer cost sharing, or to break ties among applications with equivalent scores after evaluation against all other factors). *If cost sharing will not be considered in the evaluation, the announcement should say so, so that there is no ambiguity for potential applicants. Vague statements that cost sharing is encouraged, without clarification as to what that means, are unhelpful to applicants.* It also is important that the announcement be clear about any restrictions on the types of cost (e.g., in-kind contributions) that are acceptable as cost sharing.

The APPENDIX to this paper includes examples of Federal agencies and programs known to have policies and practices that conflict with the OMB regulations and the directive. These situations should be addressed immediately and brought into compliance with official Federal guidance. As other examples are identified, they should be addressed to ensure agency compliance with Federal cost principles.

SUMMARY OF THE APPENDIX: ARBITRARY AGENCY POLICIES AFFECTING COST REIMBURSEMENT

The APPENDIX identifies diverse examples of arbitrary agency policies that contribute to the university subsidy of federally sponsored programs. ***The NIH K-award program is an example where an entire program has been made subject to an artificial F&A capped reimbursement at 8%***, when in-fact, the K-award program is a lab space intensive program similar to the R01 Research Project Grant program. Other examples of artificial F&A caps are commonplace for programs sponsored by the Department of Education, as well as by other agencies. The APPENDIX shows a sampling of other examples, and it should be noted that agency program announcements that include arbitrary F&A limitations are commonplace – to catalog every example would be well-beyond the scope of this paper.

The NIH policy on Genomic Arrays, announced in May 2010, is an example where NIH identified large volume-expensive supply items (i.e., Genomic Arrays) and determined that these items generated disproportionately large F&A payments. Even though OMB Circular A-21 premises that the entire F&A rate determination process be based on an “averaging” concept (i.e., some items generate more F&A, others generate less), the NIH policy disregarded this concept in the case of the Genomic Arrays policy.

The NSF Salary policy has been based on a 2-month reimbursement model for many years. While this example is unique compared to other examples in the APPENDIX, the 2-month reimbursement policy should be noted for creating an artificial salary reimbursement cap. The history of the 2-month limitation is nuanced and it may require actions above and beyond the “Request for OMB and Agency Action” shown in the next section. However, the NSF Salary policy is another example of an arbitrary agency policy that creates financial challenges for research institutions.

The examples in the APPENDIX are not all-inclusive, but are a significant representation of arbitrary agency limitations on reimbursement. While we capture the cost impact in selected situations only, the inconsistent application of federal guidelines affects research institutions in multiple ways. In addition to the financial consequences, ***another impact includes the compliance burden related to developing business processes, artificial accounting constructs and information technology solutions to administer agency deviations*** – internal operational processes as well as audit and monitoring processes must be established to ensure that compliance with every agency policy is maintained.

REQUEST FOR OMB AND AGENCY ACTION

We urge OMB and the Federal funding agencies to work closely with the research community to establish compliance protocols that are consistent with the official Federal guidance from OMB Circular A-21 and the 2003 OMB Policy Directive. We propose the following action items:

- 1) **The Negotiated F&A Research Rate, unless statutorily prohibited, should be accepted by all Federal funding agencies on all federally sponsored research programs.** As stated in section G.11.b of Circular A-21: *“The negotiated rates shall be accepted by all Federal agencies”*.
- 2) **Other Negotiated F&A Rates** (e.g., Instruction rate, Other Sponsored Activity rate, Off-campus rate, etc.) for programs not identified as research, unless statutorily prohibited, should be accepted by all Federal funding agencies on all applicable federally sponsored programs (e.g., training, public service, clinical trials, etc.).
- 3) **Voluntary Cost Sharing Commitments should be explicitly prohibited** – the National Science Foundation (NSF) has implemented this policy, beginning January 2011. When program officials

“encourage” institutions to pledge voluntary cost sharing commitments and/or waive F&A costs, this results in the draining of institutional resources, an environment of unhealthy gamesmanship, and a degradation of the peer-based merit review system.

- 4) **OMB should write a “Memorandum to Agency Heads” that reaffirms the official Federal guidance** from OMB Circular A-21 (including A-122, and OASC-3) and the 2003 Policy Directive on Financial Assistance Program Announcements – the Memorandum should direct agencies to comply with federal guidelines. Active OMB oversight of agency policies during implementation of the American Recovery and Reinvestment Act of 2009 (ARRA) helped contribute to an effective execution of ARRA where cases of arbitrary agency policies were kept to a minimum. The same OMB oversight model for ARRA should be applicable to all financial requirements of Federal agencies and programs.
- 5) **OMB should establish protocols where institutions can contact OMB** in those situations where an agency is not following the official guidance in OMB Circular A-21 (including A-122, and OASC-3) and/or the 2003 Policy Directive on Financial Assistance Program Announcements. These protocols should include directions for agencies to revise the applicable funding announcement to be in compliance with the official federal guidance.

CONCLUDING THOUGHTS

Research excellence and productivity of faculty and investigators is enhanced when an institution is financially stable. Furthermore, financial stability advances the research mission by reducing faculty administrative burden, which then allows the research enterprises’ most valuable resource, the faculty, to fully devote their time and resources to conducting their research.

Achieving an equitable level of cost reimbursement is important to the discussion of financial stability. OMB Circular A-21 states: *The principles are designed to provide that the Federal Government bear its fair share of total costs.* “Fair share”, as COGR understands it, is based on the shared value proposition between the Federal government and research institutions that research discoveries are critical to the educational, economic, and medical well-being of our country. The Federal government assumes the primary role of funding basic research, with research institutions contributing significant additional resources as part of their broad educational mission. Both the Federal government and research institutions provide direct cost contributions based on the budget determinations of each, and the corresponding F&A reimbursement is based on the application of the F&A rate to the direct cost contributions of each – honoring that formula will help ensure that the “fair share” objective is met.

Research institutions are committed to maintaining their significant contribution to the research enterprise – implementation of the recommended action items by OMB and the funding agencies will not affect this commitment. There may be a short-term affect that shifts some federal funding from direct to indirect costs – however, this can be managed by a “phase-in” approach to policy changes. If the axiom that research excellence and financial stability go hand-in-hand is valid, then the Federal government, Faculty and investigators, University administration, and other research enterprise stakeholders share the common interest of supporting implementation of the action items. Finally, implementation of the action items will begin to resolve the tired debate on the correct balance between Federal funding and Institutional funding and what constitutes the fair level of cost reimbursement to research institutions – a debate where it is due time for the research community to show progress.